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FISCAL YEAR 1986 SEQUESTER ORDER
The Balanced Budget and Emergency Deficit Control Act of 1985

HEARING

BEFORE THE

COMMITTEE ON THE BUDGET
UNITED STATES SENATE

NINETY-NINTH CONGRESS

SECOND SESSION

JANUARY 22, 1986

CBO-OMB REPORT
GAO REPORT

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FISCAL YEAR 1986 SEQUESTER ORDER—THE BALANCED BUDGET AND EMERGENCY DEFICIT CONTROL ACT OF 1985

WEDNESDAY, JANUARY 22, 1986

U.S. Senate,
Committee on the Budget,
Washington, DC.

The committee met, pursuant to notice, at 2:08 p.m., in room SD-608, Dirksen Senate Office Building, Hon. Pete V. Domenici (chairman of the committee) presiding.

Present: Senators Domenici, Armstrong, Boschwitz, Andrews, Symms, Grassley, Kasten, Quayle, Gorton, Chiles, Hollings, Johnston, Sasser, Metzenbaum, Riegle, Moynihan, Exon, and Lautenberg.

Staff present: Stephen Bell, staff director; Bill Hoagland, deputy staff director; and Sue Nelson, senior analyst for budget review.

For the minority: Richard N. Brandon, staff director; John Hilley, senior economist; and Alan Cohen, senior economist.

Chairman Domenici. All right. Could we have order. We just have a couple of hours today for all three witnesses and I would like very much to get started.

I understand that the OMB Director is detained, but should be here shortly. Is Rudy Penner here? Is he detained also? It looks like the only one here is the referee. Is that right? All the rest of the people came, Senator Chiles, because they think we are going to give them some relief today from Gramm-Rudman. I hope they understand that we cannot do that.

I wonder if the staff can find out where Mr. Penner is. Well, why don't we get ready for the witnesses. We have one here. Let me start by setting the agenda and by making some brief opening remarks.

First of all, before I start, could I just say to Senator Chiles, who is back with us, that we are delighted with the success of his surgery and his return to excellent health. From what I am told, you are better than ever, and I hope that means you are going to take it easy on us, even though you are feeling strong and healthy.

I hope this is a good year for all of us, and I hope that what you have told me about the state of your health is not only true today but true for a long time. [Applause.]

Senator Chiles. Thank you very much, Mr. Chairman. I appreciate those remarks, and I appreciate my colleagues' response. All your thoughts and prayers were very helpful to me.

I want to say, in addition to my health improving, I know that your health is going to improve as well.

Chairman DOMENICI. Who is that? Me?

Senator CHILES. You, yes. My understanding is we are going to be able to retire your electric smoke trapper now that you have quit smoking. He had to buy that thing a year ago so that we could breathe.

We can start reducing the deficit right now by selling off the two batteries that run your machine, and get right on the path of maybe bypassing Gramm-Rudman-Hollings with an effective plan to chop the deficit.

Chairman DOMENICI. All right. Thank you very much. I hope that this 8 or 9 weeks without cigarettes does not make me more unbearable as your chairman than I have been in the past.

Senator LAUTENBERG. That is impossible.

Chairman DOMENICI. That is impossible. You heard who said that, the most junior member, who gets to talk in committee and even gets to offer amendments that are considered seriously, and he is already complaining. [Laughter.]

OPENING STATEMENT OF CHAIRMAN DOMENICI

First, I want to welcome our witnesses. I understand that the OMB Director will be here shortly.

He is detained because of the inability of his automobile to make it here without some interference. Apparently, some people would like him to be detained, but that is being handled, and he ought to be here, shortly.

I know that the three witnesses have had very busy schedules. OMB, in addition to doing the Gramm-Rudman work, has been working on the new budget.

CBO completes its annual report, which is no little job, and in addition has completed the work required by the Gramm-Rudman-Hollings bill.

And so, for starters, let me say on behalf of the committee, that we are grateful for you finding the time to come here, and your willingness to appear at this very busy time in your schedules.

As soon as the Director of OMB arrives, we have arranged that he will testify first, and that he will answer questions first, so as to accommodate to his schedule. One of the Senators indicated that Gramm-Rudman-Hollings has sequestered the OMB Director's car. Is that what you were saying? That is apparently why he is not here.

I think you all know that while we have been in recess they have been preparing the sequestration report. You all have the report before you.

NEW PROCEDURES ESTABLISHED

I think everyone is aware that under that Balanced Budget and Emergency Deficit Control Act of 1986, a new set of procedures was established.

Those new procedures require that CBO and OMB prepare a report estimating the amount by which the projected deficit exceeds the maximum deficit amount for that particular year.

The amounts and percentages by which various budgetary resources must be reduced, to eliminate any deficit excess are discussed in that report.

The new law requires that a joint CBO–OMB report be sent to the Comptroller General who is charged with reviewing the joint report, for accuracy, and for resolving any disputes between the two agencies that were identified in their report.

The Comptroller's final report is sent to the President and becomes the basis for the sequester order that the President issues. Gramm-Rudman-Hollings wasted no time in setting these new procedures in place. For the current year, the joint CBO–OMB report was to be transmitted to GAO on January 15. The GAO was to complete its review and send it's report to the President by January 21. Despite tremendous time constraints, all three organizations have met their time schedules, an example I hope Congress can follow as we proceed through this year's work.

The Comptroller's report was issued yesterday, and it will serve as the final sequester order for this fiscal year, when issued by the President on February 1.

We have asked the witnesses to review their reports with us. I am sorry that the members did not have the report sooner, but as I indicated, the final report by GAO was only finished yesterday.

We asked the witnesses to testify before us as to any disagreements that they had, and describe how those disagreements were resolved.

We are also interested in conceptual issues that OMB and CBO identified in applying the new law. These would include the issue concerning the Washington Metropolitan Area Transportation Authority, which I understand was forwarded to GAO for a final decision.

While it is not for me to determine how others view this hearing, from my standpoint, I hope that we would discuss technical matters and not fiscal policy matters. The OMB Director will be back before this committee on the 4th day of next month, and that will be a rather extensive hearing. He will have issued the budget for the President that day, or the day before, and I understand that Dr. Penner will be before this committee on the 18th day of February.

DIFFERENCES BETWEEN CBO AND OMB ARE FEW

As a final note, I would just state something for the record. I hope my colleagues were as impressed as I was by the few differences between CBO and OMB on technical matters.

Disputes have arisen before Congress and the administration on scorekeeping issues in the past. The fact that CBO and OMB were so close on such things as deficit estimates, size of the overall sequestered pot, and percentage sequesters, gives me some reassurance that this law could be implemented.

I again thank the two Director and the Comptroller and I note that the OMB Director Miller is here.

Dr. Miller, we have indicated that you will proceed first, after Senator Chiles' opening remarks and then the Senators will ask questions of you before the other two witnesses because of time constraints that you have.

We are sorry that you had a delay and we hope that it was not too difficult for you to get here. There is a big crowd here, but I understand there was a crowd elsewhere, also.

Dr. MILLER. We were caught in a demonstration, Mr. Chairman. I thank the committee's indulgence.

Chairman DOMENICI. And the demonstration was not directed at Gramm-Rudman-Hollings, is that right?

Dr. MILLER. No, I did not mention who I was.

Chairman DOMENICI. You did not tell them who you were. All right. [Laughter.]

All right. Senator Chiles, will you proceed, please.

OPENING STATEMENT OF SENATOR CHILES

Senator CHILES. Mr. Chairman, I want to join with you in congratulating the Office of Management and Budget, together with the Congressional Budget Office for the way in which they worked together, and the minimum differences which they came up with.

Certainly everybody had been led to believe that this was going to be much tougher. I know this only worked because people at every level, but especially at the technical level, worked very hard and very close together. So I think they ought to be congratulated on that.

I have been reading some reports from well-placed administration sources, some of whom might be in this room, that we are on the road to privitization and a sale of American assets. With all these premier showings in town before the release of the budget, I want to spend just a few minutes looking back at the road that brought us here.

If you remember, back in 1981 we put in place big spending cuts, a bigger tax cut, and a big buildup in our military spending, all of which was supposed to produce a balanced budget.

Things did not go according to plan. In 1982, we were faced with something called a "midcourse correction." The reason was that the deficit seemed to be larger than the administration had predicted, and we needed to make some adjustments.

Then in 1983, with the deficit still climbing, we started hearing that the way to approach it was something called a "downpayment" on the deficit.

It was argued that we could do a little now and the rest the next year. In 1984, we were in the Rose Garden, finding out that the "wait-for-next-year" would have to wait for the year after that. In 1985, we learned about the sequester after the oak tree fell on the budget compromise.

Every year we have had a partial response and a larger deficit. We always seem to come up with a new slogan to patch over the gaps in our absence of will.

Now, with a $220 billion deficit having poked through those gaps, half-measures and evasions just are not going to work anymore.

Gramm-Rudman-Hollings is a guillotine we have designed, to force ourselves into dealing with the deficit. When the plan was put together, we thought we would be facing deficits on the order of $190 billion.

Now, we find that we are approaching $220 billion, and if we allow these so-called automatic cuts to trigger in, it could chop the heads off both the military and the domestic spending.

GUMPTION NOW OR GUILLOTINE LATER

It seems to me that we have got two broad choices. First, we can wait till the end, doing things halfway, the way we have done them in the past. That would produce a scramble to try to avert the train wreck just before it happens.

Or we can start now, working as Republicans and Democrats in Congress, with the White House, try to work out a budget that is based on reason, good will, and a determination to get the job done. We hope the administration will be equally willing to listen to what the Congress is going to have to say in the weeks ahead. I guess it comes down to gumption now, or the guillotine later.

Mr. Chairman, I think maybe Senator Sasser wanted to have just a short opening statement for a minute or so, if that would be permissible.

Chairman **Domenici**. All right. I would like very much to ask that we forgo opening statements, since we do want to hear how these three rather independent agencies got this order into shape so quickly. You may use your time for whatever statements you might have in addition to your questions to the witnesses.

But nonetheless, at your request, I will let Senator Sasser have some opening remarks if he cares to.

Senator **Sasser**. In view of the chairman's statement I will yield until my time comes around, Mr. Chairman.

Chairman **Domenici**. I greatly appreciate that and incidentally, I will follow the rule in terms of time of arrival as the order in which you will present your questions or your opening statements. I have the sequence here, and Senator Grassley will be next, and Senator Johnston after that.

Welcome, Dr. Miller. I know this is your first appearance before the committee. You have been working on two or three fronts. We would appreciate hearing from you today with reference to the sequestration activities of your office to this point and on technical problems and difficulties that may have arisen as you attempted to interpret and apply the law.

Would you proceed, please.

STATEMENT OF HON. JAMES C. MILLER III, DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET

Dr. **Miller**. Mr. Chairman, and members of the committee. I am glad to be here today to discuss the Balanced Budget and Emergency Deficit Control Act known as Gramm-Rudman-Hollings, and in signing this act into law, President Reagan stated that passage was a dramatic step, but only a first step.

However, it strongly signifies a joint commitment by the President and Congress to control Federal spending and eliminate the deficit by 1990.

I am here today to discuss OMB's role in implementing the Act, specifically, how we went about preparing the joint OMB/CBO report submitted to the Comptroller General on January 15; how we are carrying out the sequestration for fiscal year 1986; and how we view any technical problems that may have developed in the process.

STATUTORY PROCEDURES

The act, as I indicated, known as Gramm-Rudman-Hollings, establishes a maximum deficit amount for fiscal year 1986 of $171.9 billion.

If the estimated deficit exceeds that maximum amount, an automatic spending reduction procedure is triggered. Gramm-Rudman-Hollings capped the excess deficit at $11.7 billion for fiscal year 1986, even though, as you know, the estimated deficit was much higher—$220.5 billion, to be exact. In subsequent years, spending reductions in the full amount of the excess deficit will be required, should sequestration occur.

The first step in the fiscal year 1986 sequestration process was preparation of a joint report by the Directors of OMB and CBO. That report presented estimated base levels of total revenues and outlays for the fiscal year; set forth OMB and CBO economic assumptions, including rates of real economic growth; stated the amount by which the projected deficit exceeds the maximum deficit amount; and described the calculated amounts and percentages by which various budgetary resources must be sequestered or reduced to eliminate the $11.7 billion in outlays for the fiscal year.

These amounts were calculated by budget accounts for nondefense programs, and by account, and then by the further detail of program, project, or activity for defense programs.

Where OMB and CBO disagreed on any point, the law required that our differences be averaged.

The joint OMB/CBO report was concurrently submitted to the Comptroller General and published in the Federal Register and so given to Members of Congress.

The Comptroller General reviewed the report and yesterday issued his own report, addressing the same issues.

On February 1 of this year, President Reagan will issue a final sequestration order for fiscal year 1986, based on the Comptroller General's report. Unless there is significant action by Congress in the interim, that order will take effect on March 1.

Between the issuance of the order and its effective date, the amounts for sequestration are, by law, withheld from expenditure. OMB will implement this provision of the act by issuing appropriate apportionments to executive branch agencies, making available only the reduced spending authority.

PREPARATION OF THE OMB/CBO REPORT

Now before I describe in more detail the procedures by which OMB and CBO produced their joint report, I want to express my appreciation to the staffs of both agencies for their exemplary efforts in preparing a document—as you indicated, Mr. Chairman, so complicated, this quickly.

Shortly after the act was passed, CBO Director Rudy Penner and I agreed that our staffs would begin meeting immediately to plan how to implement the act, and to exchange the information necessary to facilitate that process.

We also agreed that we would make information produced in this process available to the staff of GAO, so that Comptroller General Bowsher would have as much advance preparation as possible to perform his statutory obligations in the short time permitted.

These arrangements resulted in a most cooperative working relationship. Although many of the conceptual budget issues were difficult and novel, OMB and CBO reached agreement on all interpretive issues involving the sequestration process, except one of fairly minor consequence, not to the recipients but overall. I shall discuss that later.

OMB and CBO first estimated revenues, outlays, and the deficit for fiscal year 1986 in accordance with the requirements of the act.

The estimates assumed that current laws continued unchanged for revenues and entitlements; that fiscal year 1986 appropriations, including the continuing resolution, were available; and that expiring provisions would terminate as scheduled.

The OMB and CBO deficit estimates were remarkably similar, as pointed out. Only $800 million apart in a deficit of over $220 billion.

Averaging the two numbers produced a final deficit estimate of $220.5 billion, well above the $171.9 billion target deficit and above the $191.9 billion level that triggers the maximum $20 billion sequester on an annual basis.

Accordingly, Gramm-Rudman-Hollings required CBO and OMB to contemplate the elimination of some $11.7 billion in outlays, one-half from defense and the other half from nondefense programs.

OMB and CBO next calculated the budget base from which the reductions would be made. Approximately $241 billion in estimated outlays for nondefense programs is associated with budgetary resources that may be sequestered under the act. Some $49 billion of these expenditures are associated with programs with automatic spending increases, for which reductions are limited to the amount of the cost-of-living adjustment.

Another $87 billion is associated with programs for which the act contains special rules limiting reductions. After allowing for these special provisions and averaging the OMB and CBO estimates, we calculated that a uniform percentage reduction of 4.3 percent had to be applied to the remaining $105 billion in eligible nondefense programs to produce the necessary spending reductions.

For defense programs, the President decided to exempt from sequestration some $61.1 billion from certain military personnel accounts.

After this and other adjustments, some $109 billion of estimated fiscal year 1986 outlays were associated with budgetary resources subject to across-the-board reductions.

After making appropriate adjustments and averaging the OMB and CBO figures, we concluded that a 4.9-percent uniform reduction was necessary to obtain the required savings.

OMB and CBO then applied the respective percentage reductions for all nondefense and defense programs to each budget account within those areas and calculated the required spending reductions. For defense programs, the two agencies also calculated the amount by which each program, project or activity must be reduced. Although OMB and CBO did not agree completely as to the estimated outlays from individual budget accounts, our estimates in every case were similar, and the average did not differ significantly from the estimate of either agency.

There was only one conceptual point on which OMB and CBO were unable to agree, and that is whether Department of Transportation interest payments for Washington Metropolitan Area Transit Authority bonds are subject to sequestration.

OMB agreed with CBO that this appropriation ought not to be sequestered, but we—that is, OMB—believed this outcome was not permitted by the language of the act.

These funds constituted such a minute portion, however, of the total eligible nondefense budget base, that resolution of this issue was of no consequence to the amounts to be sequestered from other programs.

TECHNICAL PROBLEMS ENCOUNTERED

Now I've just described the process by which CBO and OMB produced their joint report. From a procedural point of view, the act proved to be workable, although the short time period available to perform the necessary tasks placed an enormous burden on our staff.

In response to the committee's request for a description of technical problems that emerged during the implementation process, I should now like to raise several points.

The first point concerns offsetting collections from non-Federal sources. Dr. Penner's statement, I understand, reviews the discussions that took place on this issue.

In OMB's judgment, the act instructs us not to reduce these collections but does require that payments financed by them be subject to sequestration.

CBO, initially, at least, held a contrary view, but in the end, CBO agreed with OMB's interpretation.

The second technical problem involves the identification of accounts subject to the act. Gramm-Rudman-Hollings defines "accounts" as either items for which appropriations are made in appropriations acts, or, otherwise, items with designated account codes in the appendix to the President's fiscal year 1986 budget.

As it happens, that is not a comprehensive definition of "budget accounts," primarily because the nonjoint items in the legislative branch are not identified in the appendix with account numbers.

To the extent these items have permanent appropriations, they are excluded by default from coverage of the act, even though this seems to be an unintended result.

The third technical problem relates to the Panama Canal Commission. One of the anomalies of our budget process is that any profit from the operations of the canal accrue to Panama, not to the United States. As a result, the savings from sequestering, which we believe is required by the act, benefit Panama, not the United States.

The fourth technical problem relates to the Federal Reserve Board. With the exception of Social Security, Gramm-Rudman-Hollings placed off-budget accounts on-budget.

We, CBO, and GAO all agreed that the language did not appear to apply to the Federal Reserve Board, or to the banks, even though if that had been the intent, we would have expected considerable discussion of such a controversial issue in the act's legislative history.

The fifth technical problem relates to the foreign military sales credit. Neither we nor CBO sequestered any budgetary resources from this fund. However, OMB considers it to be an exception that could be questioned, since it is not included in the list of explicit exemptions for similar accounts.

The sixth problem relates to revenue collections for Puerto Rico, Guam, and the Virgin Islands. There are a number of instances in which funds appear in the Federal budget as an incidental matter for convenience of administration, rather than as a means of resource allocation.

In most cases Congress recognized these situations and exempted the accounts from sequestration. It did not do so for the above-mentioned revenue collection accounts, and we felt obliged, under the law, to subject them to sequestration.

The seventh, and last technical problem, relates to the requirement that outlay reductions be made uniformly at the program, project, or activity level, as defined by Congress.

One difficulty was avoided when Congress enacted definitions of "program, project, or activity" in the continuing resolution, therefore, avoiding a direct challenge on this point under the Supreme Court's decision in *INS* v. *Chadha*. That was a decision involving the legislative veto.

ANOTHER PROBLEM CREATED

That provision in the continuing resolution created another problem, however, because Congress defined "program, project or activity" so narrowly, that in some areas it is difficult, if not impossible, for us to comply.

The Agriculture Department, for example, is required to calculate the outlay reductions separately for each of 13,000 county offices, because each was defined as a separate program, project, or activity, even though the offices may involve only a storefront with three or four Federal employees.

Not only is this very difficult to accomplish, it becomes very difficult for agencies to manage programs, if Congress insists on such detailed micromanagement.

In closing, Mr. Chairman, and members of the committee——

Chairman DOMENICI. I might mention to you, Dr. Miller, that we really tried to make that one very tight. We did not know it would be 1,300. We did not want much discretion, so we did not give you much on that, but we could have done a little better. That seems a little tight, but it did work. That is what we intended.

Dr. Miller. Well, I understand the Agriculture Department is still putting together the 13,000 reports.

In closing, Mr. Chairman, and members of the committee, I would like to reiterate what I have stated publicly during the last weeks about the effects of the sequestration order.

It is my belief that these outlay reductions can be implemented without disrupting agency programs, or requiring reductions in force.

If unexpected problems should develop, we will seek reprogramming authority, as needed.

Mr. Chairman, and members of the committee, that completes my statement. At this point I shall be happy to respond to any questions you might have. Thank you.

Chairman **Domenici.** Thank you very much. I have some questions, but I think what I am going to do is start down the list and take mine at some other point in the hearing.

So, Senator Grassley, are you prepared to proceed?

Senator **Grassley.** I have no questions of Dr. Miller. However, I have questions of Mr. Penner.

Chairman **Domenici.** Fine. I am always tolerant, Senator. Will you require twice the time because you have yielded this time, or——

Senator **Grassley.** Maybe not twice the time but maybe an extra minute.

Chairman **Domenici.** Oh, all right. Senator Chiles, would you like to proceed now, or do you want to proceed to Senator Johnston?

Senator **Chiles.** I will let Senator Johnston question.

Chairman **Domenici.** Senator Johnston.

Senator **Johnston.** Thank you, Mr. Chairman. Welcome to the committee, Dr. Miller.

Dr. Miller, less than 2 weeks after the President signed the Gramm-Rudman-Hollings bill, with great fanfare, a letter was written to the President of the Senate, Mr. Bush, by Ed Meese, the Attorney General, stating in effect that this bill was unconstitutional, at least what I regard as the central mechanism which provides for sequestration. This letter states, "But even if it is declared unconstitutional"—as Mr. Meese would have it be declared unconstitutional—"there resides alternative power within the bill which would in effect allow the budget process to go forward."

BILL CONTAINS SAVINGS CLAUSE

I want to know, do you find in this bill alternate procedures equal in dignity, or effectiveness, to the sequestration order, and if so, what are they, and how do they differ from the present powers contained in the Budget Act as amended?

Dr. Miller. Senator Johnston, the Attorney General took issue with the question of whether the participation of the Comptroller General was constitutional, because as you know, the role of the Comptroller General in Gramm-Rudman, is in a sense to order the President to in turn issue an order.

It has been the position of the Attorney General that the Comptroller General is an officer of the legislative branch of Government, rather than the executive branch of Government.

Senator JOHNSTON. I understand that position, I have read the brief, but my question is from a machinery standpoint, a decision declaring the current mechanism unconstitutional takes away sequestration, and therefore——

Dr. MILLER. In my opinion, that is incorrect, Senator.

Senator JOHNSTON. You could proceed with sequestration?

Dr. MILLER. Yes; under my interpretation of Gramm-Rudman, as passed, should the participation of the Comptroller General be found unconstitutional, there is a savings clause which would have a joint resolution of Congress—that is, an ordinary law—signed by the President, replace the role of the Comptroller General. Then the joint report of OMB and CBO would be issued to the Congress and to the President, rather than to the Comptroller General.

Senator JOHNSTON. Well, what I mean is, the sequestration would have to be carried out by joint resolution?

Dr. MILLER. My understanding is the joint resolution's purpose would be only that of determining what the deficit would be, and the rates of growth, for purposes, as you know, depending on the rates of growth, there could be certain provisions of Gramm-Rudman that could be waived.

But that joint resolution would only go to the question of the projection for the future, not whether there should be sequestration.

I realize, of course, that should there be inaction by Congress, that the effect might well be to delay or refuse sequestration.

Senator JOHNSTON. Yes; it seems to me that that is a basic problem. In other words, under the present law, if you have got a majority vote of both Houses of Congress, you can do whatever you want to do to the budget.

So, if you take away that provision that Mr. Meese says to take away, then you are left in effect with the same requirement of joint action by the Congress as we had before Gramm-Rudman.

Dr. Miller——

Dr. MILLER. Well, Senator, as you know, or as you may know, we shared views with Members of Congress who were drafting the legislation on our concern, and the President did indicate, in signing the law, certain reservations about the constitutionality of those provisions.

There might have been more effective ways of dealing with it such as just leaving——

SAVINGS FROM RECONCILIATION

Senator JOHNSTON. Let me pass on to another matter if I may. On reconciliation, do you concur with what I understand to be the current CBO view that reconciliation would save about $8 billion the first year, and $21 billion over 3 years?

Dr. MILLER. That is a new number for me, Senator. My understanding is that the CBO estimates were much higher than that, but they were predicated on assumptions that go back to the first of the last calendar year.

Senator JOHNSTON. Well, what would be your estimate? Do you have an estimate?

Dr. MILLER. Our estimates of the effects of reconciliation and again, it depends on the House version or the Senate version, are much more on the order of $20 billion, rather than the $60 or $80 billion for the 3 years that have been advertised.

Senator JOHNSTON. Yes. I understand their new numbers are $21 billion for 3 years and $8 billion the first year.

Dr. MILLER. That is much more in line with the estimates that we have generated.

Senator JOHNSTON. Now Dr. Miller, as you know, the price of oil has dropped precipitously. Last year, the Armed Services Committee criticized the Defense Department for padding its energy accounts, and, in fact, used funds from those accounts as a means to find a lot of extra money to avoid some cuts in other programs.

Now do we know how much is spent on fuel in the Department of Defense, collectively, and therefore, how much would be saved if you can assume that the average price of oil from here on out, for the rest of the year, would be, say, $20 a barrel instead of that which it was——

Dr. MILLER. I do not have those figures with me, Senator. I would be glad to provide them for the record, if you would like.

Senator JOHNSTON. Yes. I would appreciate that very much.

[The following was subsequently supplied for the record by OMB:]

The Department of Defense budget contains $6 billion for the purchase of petroleum products. This amount reflects OMB's guidance to assume crude oil prices of $25.16 per barrel in 1986 and $24.08 per barrel in 1987.

If crude oil prices dropped to $20.00 per barrel for the last half of FY 1986 and stayed at that level throughout FY 1987, we estimate that Defense would save $500 million in FY 1986 and $800 million in FY 1987.

OIL IMPORT FEE NOT FAVORED

Senator JOHNSTON. With this drop in the price of oil, would the administration be willing to reconsider its views on an oil import fee, or, if we could call it an oil user fee, if you want to?

Dr. MILLER. I do not think so, Senator. The President has, I think, spoken fairly clearly on that.

Senator JOHNSTON. All right. Could we get, when you are furnishing things to the committee, could we get a State-by-State breakdown in the reductions caused by Gramm-Rudman in all accounts, not just revenuesharing, but in each one of the accounts, so that we can——

Dr. MILLER. We will provide you—let me say first, Senator, I am trying to be helpful. The people who might have access to that information are working extraordinarily long hours right now trying to produce the budget.

When the budget has been produced, then perhaps we will have more leisure time to look at these issues. It may not be possible, in all cases, to provide the accounts by State, but we will provide you what we can.

[The following was subsequently supplied for the record by OMB:]

For a number of technical reasons, it is not possible to develop State-by-State estimates of the effect of the Gramm-Rudman-Hollings sequester with an acceptable degree of accuracy. For example:

The FY 1986 sequester process began well after the start of the fiscal year and otherwise sequesterable funds within some accounts had been obligated and expended before the sequester order was issued. An extensive, time-consuming survey of the agencies would be required to determine the State-by-State initial impact of the order. Arbitrary allocation factors will not produce reliable estimates.

The regional impact of some types of spending depends upon decisions that will not be made until later and that cannot be forecast with certainty. This is particularly true of competitively awarded contracts and grants.

The data sources containing State-by-state distributions of Federal activity, on which estimates of the regional impact of sequester would have to be based, are related directly or indirectly to obligations. Obligations data cannot always be translated in any simple way to new budget authority or outlays, which are the primary sequester data. This is particularly true for data pertaining to a single year.

The Gramm-Rudman-Hollings sequester, like a rescission, reduces the funds available for an account and, within the account, program, projects, or activity. It does not change any of the existing rules of program administration, such as reprogramming. It is entirely possible and proper, therefore, that the post-sequester allocation of resources within an account will change to reflect changed circumstances. In such cases, the effect of sequester could be far outweiged by the effects of other factors.

There are special difficulties associated with the State-by-State effect of sequestration on defense procurement. For these contracts, data are not available on secondary or tertiary contracts even before sequestration. Moreover, State by State sequestration data would have to be developed for each of hundreds of programs, projects, and activities. Such an effort would be extraordinarily complex.

For Federal civilian and military employees, the sequestration will also be carried out by the hundreds of programs, projects, and activities in accordance with the law. Information on the State-by-State location of Federal civilian and military employees in each of these activities is not available, and collecting such data would be very burdensome.

The Office of Management and Budget does prepare each year, primarily for the benefit of State governments, the Budget Information for States (BIS) report, which contains State-by-State distributions of obligations for major Federal formula grant programs. The data contained in the BIS report consistent with the FY 1987 budget are post-sequester. In addition, the Census Bureau produces a report covering State-by-State estimates for all Federal grants to States, and a more comprehensive report, Federal Expenditures by State, which covers most Federal expenditures. FY 1986 data from these sources will not be available for another year, but the State-by-State percentage distributions shown in the latest of these reports are probably close to what the FY 1986 distributions will be.

The Gramm-Rudman-Hollings Act requires that the automatic spending reduction—4.9 percent for sequesterable defense funds and 4.3 percent for sequesterable nondefense funds in FY 1986—be applied uniformly by account and, within accounts, by program, project, or activity. This requirement is being carried out faithfully by the agencies, so I can assure you that no discretionary action is being taken that would favor one State relative to another. I am confident that the residents of all States are benefiting from the increased economic activity that seems clearly attributable to passage of the Act.

Senator JOHNSTON. One final question. What is the view of the administration toward the role of the President under article II as Commander-in-Chief?

Are there any situations under which the President, under article II, as Commander-in-Chief, in your view, could disregard sequestration?

Dr. MILLER. Well, I am not a lawyer, and I do not speak on legal matters for the President, so I think I would defer to those who would.

However, I would say that I have heard no discussion of that contingency around the White House.

Senator JOHNSTON. Thank you, Dr. Miller. Thank you, Mr. Chairman.

Chairman DOMENICI. Thank you, Senator. Senator Andrews.

Senator ANDREWS. Thank you, Mr. Chairman.

Dr. Miller, it is good to have you here. I am kind of concerned, though, about this Gramm-Rudman thing. It started out sort of like what my friend Senator Hollings and I put together as an across-the-board freeze.

Later on, when it finally emerged, I could not recognize my own child, so I voted against the Gramm-Rudman proponents.

In the final analysis, it claimed failure as the basis for its success; claimed failure as the need for Gramm-Rudman; failure of the congressional and Presidential will; failure of the congressional budget process; failure of the appropriations process; failure of the constitutional doctrine of the separation of powers.

And for one who believes in the strength and ultimate triumph of all of the above, with the possible exception of the budgetary process, I find Gramm-Rudman to be, quite simply, wrongheaded.

You must admit that failure is certainly a unique basis for legislation that, if ever fully implemented, could radicalize and polarize this Nation to a degree never quite seen before.

Gramm-Rudman is "flat earth" political and economic policy. It gives the President and the Congress the legal authority to make sunbeams out of cucumbers, I suppose, but it does not allow them to make either good public or fiscal policy.

Galbraith once said that "Politics is not the art of the possible, it consists in choosing between the disastrous and the impossible."

GRAMM-RUDMAN IMPOSSIBLY DISASTROUS

Gramm-Rudman eliminates the choice. It is simply impossibly disastrous. We find this in such things as transportation, where we argued our way through a budget cut in FAA and Coast Guard that was mandated to us.

We made the cut to get under the budget limitation. We had to restore it in the CR, and we did restore it, over the objections of several of you who wanted to keep those figures down. Now we find two things have happened. Last week, under Gramm-Rudman, we are getting a further cut order of $1.8 billion. We would have to take $200 million out of FAA.

This morning, I was told at the White House that we have got a supplemental request to increase FAA. Which do we go along with?

How do we know where we are supposed to go? Do you, Jim, hold forth as telling us we should cut the FAA? Or does the President's request to increase it in a supplemental have precedent?

Dr. MILLER. Well, let me say first, Senator, we have a very large budget deficit and we have had it for several years, and it seems——

Senator ANDREWS. No one knows that better than we do on this committee.

Dr. MILLER. It seems intractable. Gramm-Rudman consists of a compact between the President and Congress to reduce that level of deficit down.

The budget the President will submit in a few weeks carries out his side of the bargain. He will propose a budget that meets those targets, and we are carrying out our part of the bargain right here in issuing the sequester order.

Now your point, I think, is correct, inasmuch as sequester does, has lowered certain accounts, and there is a possibility that some emergencies might be dealt with by means of a supplemental. But I have not approved any supplemental for the FAA or anyone else at this point.

Senator **ANDREWS**. OK. Well, then that rumor I got this morning was wrong. But let's take a look at another thing, briefly.

Dr. **MILLER**. I think, by the way, that could be handled in different ways.

REDUCTIONS IN SPENDING AUTHORITY FOR USER FEES

Senator **ANDREWS**. But the result of reductions in spending authority for user fees is also in this, and that is patently absurd.

For example, the Federal Grain Inspection Service is 85-percent funded by user fees. The Gramm-Rudman order cuts these user fees, and it saves no appropriated funds. It just cuts the level of service.

We do exactly the same thing under Gramm-Rudman in Customs Service's user fees, which are also 85 to 90 percent of the total funding for that program.

Dr. **MILLER**. Could I ask, Senator, for a clarification. My understanding is the law does not allow us to reduce those offsetting collections, but our interpretation was the use of those moneys, that then once they are collected their treatment is a budgetary resource and they are subject to sequestration.

Senator **ANDREWS**. As I understand it, and I have been told, is that it does not allow you to cut back the collections but you mandate a cutback in the people doing the service.

Dr. **MILLER**. That is true.

Senator **ANDREWS**. And if you mandate a cutback in the people doing the service, the collections, it follows, will be less.

Dr. **MILLER**. That is not our interpretation of the law. That may be a policy choice that you would make, but that is not the interpretation of the law——

Senator **ANDREWS**. Well, nonetheless, Jim, aren't you mandating a cutback in the number of personnel in the grain inspection service, in the customs inspection service?

Dr. **MILLER**. We are mandating it subject to my checking these particular accounts, whether they do fall in the base or not; if they are in the base they will be cut back, even though the user fees would not be cut back.

That is our interpretation of the law——

Senator **ANDREWS**. Even though they are——

Dr. **MILLER** [continuing]. And they would be cut by account. It is not necessarily the number of people that would be cut back. It would be 4.3 percent of the amount in the account.

Senator **ANDREWS**. But as we interpret it—and that is why we would like the answer—you are asking a cutback in the personnel in these services, even though what they do is totally funded by the user fees.

This, to me, looks wrongheaded, and I would hope we could take another look at it. We have a couple of——

Dr. **Miller.** Senator, I am just following the law. That is what we interpret the law to require.

Senator **Andrews.** Jim, I am not speaking against you. My initial premise was that this law is wrongheaded and impossible to administer, and possibly disastrous, as I did to pick a phrase out of Galbraith, and I think you have added to that. Thanks, Mr. Chairman.

Chairman **Domenici.** Senator Moynihan.

Senator **Moynihan.** I welcome you also, Dr. Miller.

Dr. **Miller.** Thank you.

PRELIMINARY ESTIMATES FOR 1987 DEFICITS

Senator **Moynihan.** Could I just look ahead one bit and ask if you—do you have any preliminary estimates of what you think the deficit for 1987 will be?

Dr. **Miller.** Yes, sir; I do.

Senator **Moynihan.** You do. Will you share them?

Dr. **Miller.** Close to $200 billion on current services; above $190 billion.

Senator **Moynihan.** Yes; well, in your very good testimony here, you make the point that as you look through this legislation, with respect to the nondefense programs, you found $105 billion that you could apply sequestration to.

And then, on the defense side, $109 billion. A total of $214 billion could be sequestered, which is a little bit less than a quarter of the budget. And you only had to take $11.9 billion out of that $214 billion. If you have to take $60 billion the next time, will it still come out of about $214 billion?

Dr. **Miller.** There would be, subject to the fact that the rules for defense are different in 1987 than they are in 1986. The President—my understanding of Gramm-Rudman—the President does not have the authority in 1987, to exempt the military personnel account.

Also, there is flexibility, that the Defense Department does not have with respect to——

Senator **Moynihan.** So you do contemplate a cut in that area of the budget available to you, of upward of 25 percent?

Dr. **Miller.** I am not sure I understand, Senator.

Senator **Moynihan.** Well, if you take $60——

Dr. **Miller.** The base for defense may be larger than $109 billion.

Senator **Moynihan.** Yes; but if you take $60 billion out of something less than $300 billion, you have taken more than 20 percent. I mean, these are big cuts.

Dr. **Miller.** Yes; if they are sequestered. But the point is that if Congress——

Senator **Moynihan.** If they are sequestered?

Dr. **Miller.** If it is sequestered. I think though that——

Senator **Moynihan.** Could I just ask you two other quick things here?

Dr. **Miller.** Yes.

REDUCTIONS WOULD BE COUNTERPRODUCTIVE

Senator MOYNIHAN. When you proposed the reductions in the Internal Revenue Service, was there any estimate from the Internal Revenue Service about what that would mean in lost tax collections?

Dr. MILLER. Yes; there was a feeling on the part of the Internal Revenue Service that this would be counterproductive inasmuch, with respect to revenue, looking only at revenue, inasmuch as the savings from the reduction in the number of IRS agents and auditors would not be as great as the reduction in the revenue, because of not policing the accounts quite as carefully.

Senator MOYNIHAN. Would it be fair to estimate that in IRS it is thought that we may lose as much as $1 billion in tax collections as a result of this sequestration?

Dr. MILLER. I do not know the specific figures. There is always a question, Senator, as you probably well know. What is the optimal number of auditors?

Do you want to go to the point that you have one auditor for every dollar and transfer——

Senator MOYNIHAN. We, right now, have the lowest ratio of auditing in the postwar history of the country, I believe, and you nod in agreement, sir?

Dr. MILLER. I do not know that for a fact. I take that, surely, yes——

Senator MOYNIHAN. That is our Finance Committee who tells us that.

Dr. MILLER. Right.

Senator MOYNIHAN. We are not here to harass you, you are doing a very good job. We gave you this bill. Could you ask IRS for an estimate, in their judgment, their best professional judgment, of what the loss in funds for auditors will mean in the loss of taxes otherwise that would be collected.

Dr. MILLER. I think they provided that information without our asking. As you know—I do not recollect what it is.

Senator MOYNIHAN. Well, will you send it along.

[The following was subsequently supplied for the record by OMB:]

The IRS plans to apply the $157 million sequester in areas that will not affect revenue generating programs or returns proceeding activities.

However, if the requested supplemented of $340 million is not funded, resources will be redirected from revenue-generated programs to the critical area of processing tax returns and responding to taxpayer's inquiries during the filing season. Ensuring a smooth 1986 filing season is the top priority for the Administration, even if it means a loss in revenues.

If the supplemental is not funded, the estimated loss in revenues is about $1 billion in 1986.

Dr. MILLER. In the law, there is a request for a specific study along these lines, as I recollect.

Senator MOYNIHAN. But would you send the committee——

Dr. MILLER. I will send you whatever I can.

FOREIGN MILITARY SALES CREDIT

Senator MOYNIHAN. And one last thing, Mr. Chairman. In your statement, sir, you say of the technical problems you ran into, one was the foreign military sales credit, which you say that you did not sequester, or you did not find that you could do that.

That is in your testimony. But in the Federal Register, you have got us down here as sequestering $223 million in foreign military sales. That is on page 17.

Dr. MILLER. I understand that this is foreign military sales credit. I understand it is a different account from what you are reading, but I will be glad to answer that in more detail, in writing, if I could.

Senator MOYNIHAN. I would appreciate that very much. Thank you. Welcome, again.

[The following was subsequently supplied for the record by OMB:]

Two separate accounts are being discussed. The Foreign Military Sales Trust Fund (FMSTF), budget identification number 11-8242-0-7-155, is not subject to sequestration under Gramm-Rudman-Hollings. Consisting of no administrative or operating expenses, the account is specifically exempted from reduction under Section 255(g)1 of the Act.

The Foreign Military Sales Credit (FMSCR) program, budget account number 04-09-1082-x-1-152-A, 11-1082, consists of appropriated funds and is sequestrable under Gramm-Rudman-Hollings. The reduction required in 1986 for this account is $223,170,00.

Dr. MILLER. Thank you, Senator.

Chairman DOMENICI. Thank you, Senator. Senator Boschwitz.

POT WILL BE BIGGER NEXT YEAR

Senator BOSCHWITZ. Dr. Miller, I would point out also to my friend from New York, Senator Moynihan, that next year, the pot will be made a little bit bigger. Not only because certain defense items will not be exempt from sequestration, but I presume that other programs—outlays from prior year appropriations and other prior legal obligations—will decrease as we get further into the Gramm-Rudman bill. Of course impacted programs such as Medicare, will be subject to a different type of reduction or impact in the second year, and thereafter, than some of the other programs.

I might say that I very respectfully disagree with some of the comments of my friend from North Dakota. He voted against the Gramm-Rudman bill. I voted for it.

Several years ago I introduced something I called the fair play budget, which was also in a way somewhat mindless because it was across-the-board. It said that the Federal Government had experienced over a 25-year period increases in revenues of about 9½ percent a year. The spending side of course was going up faster. Since we seemed to have difficulty in disciplining ourselves, I suggested, 4 or 5 years ago when the budget deficit was at $50 billion, that all programs rise, but that they rise at 5 percent, regardless of the rate of inflation. I later changed it to 0.4 percent and then the revenues would simply catch up.

And now, revenues have fallen so far behind that a stronger tonic is needed, and so I voted for Gramm-Rudman with considerable enthusiasm as a matter of fact.

I might say that enthusiasm is shared by my constituency. I have been back to Minnesota and talked to a number of people about this, and all kinds of folks expressed concerns about their individual programs. But when given an option between saving or increasing every aspect or every penny in their program or having a meaningful bill that would bring about a planned and orderly reduction of the deficit, the heads nodded throughout the audience. Not a single person came out and said to me that Gramm-Rudman is something that should not have been done.

So that while perhaps it is a little mindless—if I had a 535 person board of directors in my business we would never get anything done whether—but I felt that Gramm-Rudman was probably the only approach that would lead us out of the morass of these extraordinary budget deficits.

And as I say, it is not a great deal different than my so-called fair play budget that treated absolutely everything the same.

Senator **Andrews**. Rudy, you are always right at some point, and you were right at the point you wanted to do it, across the board. That is what we started doing. This did not go across-the-board; it just addressed one-quarter of the budget.

Senator **Boschwitz**. More of the budget will be addressed next year, less of it will be exempt. Prior year obligations and prior year appropriations will get smaller so the pot will continue to grow.

I supported including everything in the pot, even Social Security, and joined Senator Boren to introduce an amendment to that effect on the floor.

OUTLAY ESTIMATE CONSIDERABLY HIGHER

Dr. Miller, in your estimates on outlays for this coming year, I note that the outlay estimate is considerably higher than the outlays in the budget resolutions passed by this committee.

As I recall, the budget resolutions was about $965 billion. But I see that the estimates for outlays for fiscal 1986 are just a shade under $1 trillion. Indeed, the agreement between OMB and CBO, where, you were very, very close, was $996.5 billion.

What drove this figure up by about $30 billion?

Dr. **Miller**. I do not have those figures at my fingertips. Partly vis-a-vis the CBR, the performance of the economy has not been quite as predicted, which has reduced outlays slightly.

Second, we do have incorporated in these estimates——

Senator **Boschwitz**. Wouldn't the economic projections, the lack of fulfillment to those things be reflected more in revenue?

Dr. **Miller**. It would be reflected more in revenue but it is reflected some in outlays as well.

Third, we have observed that the spendout rate in the Defense Department has been slightly above what we had anticipated, what was incorporated in the CBR, as you may recollect.

The Congress adopted levels for defense that were not necessarily consistent. Since one set of budget authority numbers were used with a different set of outlay numbers.

Also, we have had the farm bill which has shifted some CCC payments into 1986 from 1987. So, those are among the reasons why our estimate of outlays for fiscal year 1986 would be above your estimate in the congressional budget resolution.

I will be glad to give you a breakdown, in writing, if you would like.

Senator Boschwitz. If you could, subject to the same restraints that you suggested before, I would like to see those increases. Defense has spent out a little slower, as I believe my friend from Florida has mentioned a little earlier.

[The following was subsequently supplied for the record by OMB:]

The following table shows the difference between the resolution estimate of outlays for 1986 and the OMB estimate in the January 15th report to the Comptroller General. The economic assumptions for the 1987 Budget show lower inflation, unemployment, and interest rates for 1986 than the assumptions of the 1986 Budget on which the resolution was based. This reduces outlays by $3.8 billion. Other changes since the resolution add to outlays. Outlays for defense increased due to a technical reestimate of the appropriate spendout rate. New crop forecasts and the Farm Bill increased outlays for the Commodity Credit Corporation by over $7 billion. Additionally, $10 billion in entitlement, user fee or offsetting receipt savings called for in the reconciliation instructions have not been achieved. Other changes including debt service added $10.0 billion to outlays.

RESOLUTION COMPARED TO CURRENT ESTIMATES
(1986 outlays in billions of dollars)

Resolution	967.6
Economic assumptions	-3.8
Defense	3.8
CCC	7.3
Reconciliation	10.0
Appropriations and other	10.0
Subtotal	27.3
January 15th estimate	994.9

REVENUE OUTLAYS LOWER

Senator Boschwitz. I see that my time has expired, but were your estimates of revenues, also higher or lower than——

Dr. Miller. Revenue outlays would be lower because the performance of the economy was not as good as the assumptions that underlie the congressional budget resolution figures of last August, which, in fairness, I would point out, are the same as the economic assumptions that were contained in the President's 1986 budget.

Senator Boschwitz. I appreciate those.

Dr. Miller. Yes.

Chairman Domenici. Thank you, Senator Boschwitz. Might I say at this time, that while these are not OMB's numbers, I do have an explanation of the deficit increase, which is prepared by the majority staff of this committee. I will ask the staff to make some additional copies and then I will make it a part of the record.

It will note, in response to that question Senator Boschwitz, that revenues are lower than we anticipated. We have not get the savings in reconciliation; that is part of the increase in the deficit.

Defense outlays are up. We estimated them at the lowest when we accepted the outlay number, but they are beginning to spend out faster.

So more will be spent for the BA allowed. There are four or five other items, the largest of which is increased costs for agriculture programs.

Senator Boschwitz. What is the total, Mr. Chairman?

Chairman Domenici. I have the combination of all of them, not just the outlays and our estimate is the same, $220.5 billion. We will make these estimates available and I will make them a part of the record.

[The following was subsequently supplied for the record:]

Senate Budget Committee staff estimate—Explanation of deficit increase fiscal year 1986

	Billions
Deficit in budget resolution	$171.9
Policy changes	24.0
Resolution revenue assumptions not achieved	2.3
Spending reconciliation not achieved (except farm bill)	7.7
Farm bill excess over resolution assumptions	7.4
Excess of appropriations over resolution assumptions	1.0
Other unrealized policy savings, net	4.4
Debt service on policy changes	1.2
Economic changes	6.9
Revenue loss	13.0
Outlay reductions	−6.4
Debt service on economic changes	0.3
Technical changes	17.7
Revenue reduction	3.3
Defense outlay increase	8.0
Agricultural programs increase	5.5
Debt service on technical changes	0.9
Total increase in deficit	48.6
Deficit in Gramm-Rudman base	220.5

Chairman Domenici. Senator Exon, you are next.

Senator Exon. Thank you very much Dr. Miller, welcome. I appreciated your opening statement and I appreciate, very much, the fact that you and the other agencies have come together. If Gramm-Rudman accomplishes nothing else, it will receive part of the credit for getting these two agencies together that have been miles apart for a long, long time.

So, maybe Gramm-Rudman is not as bad as I think it is. But I am going to violate what the chairman requested by getting into specifics with regard to agriculture, because it is so critical.

You know the depression that we have in the farm belt today. And farmers right now are planting in the south, and they are planting plantings further north. There are some things about Gramm-Rudman that are simply not understood and I am not sure that the agencies of Government understand what is happening in this area.

Maybe you can clarify one or two of these. It would be a big help to people that are trying to plant out there, and are under extreme adverse situations.

If you are familiar that when the President signed the farm bill, he said, at least the people who are producing food have the right to know what the Government program is and we want to implement it. The Secretary of Agriculture promptly came forth with his rather devastating lowering of the loan rates, which I thought was too low, but he had that authority and he has done it.

GRAMM-RUDMAN HAVING DEVASTATING EFFECT

Now, Gramm-Rudman is taking over and it is having a further devastating effect, not only on prices, but also on planting.

Here is my question or two. I can understand why the Agriculture Department is required to take out 4.3 percent. We are not going to argue about that. I think I understand that.

And with regard to deficiency payments, you know, the difference between the loan and the target price, I can understand that when the farmer comes in and signs up, he is going to say, this is a deficiency payment that you would have received, but it will be reduced by 4.3 percent, because the deficiency payments are an outlay under the budgetary process

I do not understand, and I wonder if the Department of Agriculture does, and if you can help clarify this—the Department of Agriculture is saying that also applies, not just to deficiency payments, but also the commodity loan programs, the nonrecourse loans. So we can get specific and so that you will know what I am talking about, the Secretary reduced to a $1.92 the nonrecourse loan on corn, for example. The Ag Department, today, I suggest, backed up by your Department is saying, but when that farmer comes in and signs up for this program for commodity loans, then $1.92 per bushel for corn will be reduced by 4.3 percent, which mathematically, as I understand, calculates out to $1.84 per bushel for corn.

Here is my question that I want to ask, how in the world did you come up with that? I can understand the 4.3-percent reduction on the advance on deficiencies. But I do not understand how a loan is the same as a deficiency payment?

I do not understand why you are proposing to reduce the loans given for a bushel of corn, and if you are reducing the loans, evidently you have taken the 4.3 percent against the $1.92 figure, which assumes that the corn put up as guaranteeing the loan is essentially worthless.

Can you explain that to me?

Dr. **Miller**. I am told that this is quite clear in the language of Gramm-Rudman.

Senator **Exon**. Well, I do not think that is a very satisfactory answer

By whose interpretation, I would ask?

Dr. **Miller**. You are not asking me to violate the law, are you?

Senator **Exon**. Oh, I would never do that, sir.

Dr. **Miller**. Let me read you section 251 here. It says sequestrations and reductions under the remaining nondefense program shall be applied on a uniform percentage basis so as to reduce new budget authority, new loan guarantee commitments, new direct loan obligations, obligation limitations and spending authorities, defined in section 401(c)(2) of the Congressional Budget Act of 1974 to the extent necessary to achieve any further required outlay reductions.

Senator **Exon**. Well, assuming that your interpretation of that is right, which I am not assuming at this time, my point is that you are reducing from a $1.92 to a $1.84 which is 4.3 percent of the $1.92.

Should you not only be reducing that by 4.3 percent of the difference between those two figures, rather than against the full $1.92?

You are assuming with that kind of a calculation, I hope that you will understand, that the corn put up as collateral is totally worthless.

Dr. **Miller**. Let me just give you a legal reading of that, if I could?

Senator **Exon**. Let me ask another question on deficiency, well, my time is up. I will wait for the second round if I have one.

Thank you, Dr. Miller.

Dr. **Miller**. Thank you, sir.

Senator **Armstrong** [presiding]. Senator Kasten is next.

CLEAR POLICY TO REDUCE SPENDING

Senator **Kasten**. Mr. Chairman, thank you.

Director Miller, I think that we are at a real turning point in the history of our budget and I am pleased to have you before us, here today. The Congress has acted, and I personally support that action. I voted for it and I was an original cosponsor of Gramm-Rudman. And I think that despite some of the discussions that we have had here and in the press, I predict today that the outcome of legal challenges about the procedure and that we have identified in spite of any legal challenges, a clear policy to reduce spending.

I do not know how the court challenges are going to work themselves out. I think that Gramm-Rudman will survive in the courts. But nevertheless, if a court challenge were to be successful, I think that Congress with a quick legislative action would fix that deficiency. And I think that even if we did not fix that deficiency, that we are locked in because we voted essentially for the numbers of $171.9 billion deficit; for $144 billion deficit, going on down to a zero deficit, a balanced budget, in 1991.

So, whether we do it through Gramm-Rudman, through sequestration, through what we do here in the Budget Committee, or working back and forth with the administration, I think that we have got these targets and I believe that we owe it to the American people to make the budget reductions which we have agreed on.

I do agree with you—we do, in effect, have a contract, and that contract goes beyond the legal challenges. I think also that what we are doing here today, has the widespread support of the people all across America, across Wisconsin, in terms of making these reductions.

MARKET RESPONDS POSITIVELY TO GRAMM-RUDMAN

Now, we have heard an awful lot of discussion about the negative impacts of Gramm-Rudman. Lots of stories about programs that are going to be cut, benefits that are going to be reduced. I wonder if you could try to help us in just the couple of minutes that I have got—what will be the actual benefit of Gramm-Rudman to an average family? Let us take an average family in Wisconsin, as we see these benefits and these different support programs under question?

But at the same time, as we see a Federal budget racheted down?

Dr. **Miller**. Well, I think if you look at what is coming up in terms of reducing the deficit by say, $50 billion, you are looking at something like $500 for every family in America. The reduction of the deficit, I think, is very important because otherwise, it poses a threat to our continued economic expansion. You have had a very fine recovery and expansion and that may well be threatened by continuation of such high deficits. You need to get them down, not that we are really in the business of trying to maximize the stock market in some way, but I think the fact that the market, the stock market responded very positively when Congress agreed to Gramm-Rudman is evidence that they believe that, the way that I would translate it, is that the real rate of interest would come down some.

Senator **Kasten**. Could you express that in terms of not, the stock market so much, but jobs, the cost of a cart of groceries, home mortgages, other kinds of things that the average family would be affected—what would be left in the banking account at the end of the month?

Dr. **Miller**. Well, if the real rate of interest were to fall, we would find that mortgage rates would fall; payments for families for a home would fall; quantity demanded of investment would go up and that will create jobs, that will create additional economic activity. It will create additional sales.

I do not have at my fingertips a quantification of those particular effects, but they are quite substantial. I do not think that there is any question, but that the viability and the vitality and the continued expansion of our economy hinges upon our doing something responsible about the deficit. As I testified for my confirmation, I think it would be wrong to attempt some precipitous overnight cure of the deficit problem, as in trying to eliminate the deficit tomorrow, through increasing taxes or something like that. But to get the deficit down over a period of several years—4 or 5 years, seems to me the most prudent course to follow, and it is one that I think is going to have the maximum effect, positive effect on our economy, and the opportunities for all Americans.

Senator **Kasten**. Let me in just the couple of seconds that I have remaining, switch subjects for a second.

GRAMM-RUDMAN DOES NOT APPLY TO FEDERAL RESERVE BANKS

It is my understanding that the Federal financial institution regulatory agencies, instead of the Federal Deposit Insurance Funds, we are talking about the Federal Deposit Insurance Corporation, Federal Insurance Savings and Loan Corporation, the National Credit Union share insurance funds, except for those, are subject to budget reduction provisions under Gramm-Rudman.

Is that, in fact, the case? My question is, How is this justified because no tax dollars are used to support the funding of these agencies?

Dr. **Miller**. Senator, I raised this earlier. All three agencies agree that the language did not appear to apply to the Federal Reserve Board or the banks, even though, if that had been the intent, we thought that there might be legislative language to that effect.

Senator **Kasten**. Let me at a later time, follow up on this question, because I do not understand how there is no effect on tax dollars without tax dollar support. And it would seem to me that that would be difficult to justify. But we will follow that up at a later time.

Dr. **Miller**. I understand that the administrative expenses were sequestered.

Senator **Kasten**. Thank you, Mr. Chairman.

Senator **Armstrong**. Senator Lautenberg is next.

Senator **Lautenberg**. Thank you, Mr. Chairman.

Dr. Miller, I was interested in your presentation. I would have to tell you that I do not envy you and your earliest assignments as the new Director. We have had a chance today to explore some of Gramm-Rudman at work. I thought it was an ill-conceived plan, I voted against it, and I am "Gramm" glad I did vote against it.

But, like others of my colleagues here, I think it is essential that we reduce the deficit, that we get our hands on our fiscal policy and our fiscal condition.

I got my book on the sequestering orders, with a bunch of pages upside down and backwards, and I thought that was a pretty clear reflection of what Gramm-Rudman was about. Gramm-Rudman cuts will impose hardships on many Americans. At the same time, Gramm-Rudman cuts $140 million in funding for the Internal Revenue Service, which will further hamper our ability to collect revenue due and owing the Government. Treasury estimates that $90 billion in taxes is going uncollected each year.

NO REPROGRAMMING REQUESTS APPROVED

We can argue about that figure, but I assume that Treasury cannot be off by more than a small percentage. Collecting a part of that would help relieve the burden considerably for each member of our society.

As we look at what is ahead, Dr. Miller, I wondered whether you had any views on what, if any, reprogramming of funds we might expect? Will there be an effort to move funding from one project or program to another in order to cope with the across-the-board cuts? I understand that is under discussion now.

Do you have any feel for reprogramming requests that we might be facing?

Dr. **Miller**. I do not have a precise number at this point. I have approved no reprogramming requests. I doubt that we have very many. I really doubt that we will have very many reprogramming requests, in excess of those that we ordinarily experience during the year. I mean, as the fiscal year winds on, agencies find that certain kinds of accounts are bereft of funds and others are fat, depending on how they carry out their policies, and there are reprogramming requests.

But for the specific purpose of meeting Gramm-Rudman, shortfalls, I do not anticipate—I surely, personally am not going to look upon reprogramming requests approval very approvingly. We are going to make the belt tightening cuts. We are going to meet the

Gramm-Rudman reductions with minimal disruption. But should there be real problems of some kind, that I do not know about today, we may handle it with reprogramming. But again, I do not expect the extent of reprogramming to be truly unusual.

Senator **Lautenberg**. The reprogramming process would not differ from normal.

Dr. **Miller**. We have a process for that, that is all.

Senator **Lautenberg**. Right, but there is not a normal reprogramming schedule each year. I mean, otherwise——

Dr. **Miller**. Reprogramming, my understanding is handled on an ad hoc basis.

Senator **Lautenberg**. Right, so additional reprogramming will be handled ad hoc, if it happens at all?

Dr. **Miller**. Right.

It usually happens later in the fiscal year.

Senator **Lautenberg**. Yes.

SUPPLEMENTAL FOR IRS POSSIBLE

Mr. Miller, the Wall Street Journal reported that the administration might be sending up, or will be sending up a revised supplemental for IRS. Are you aware of anything of that nature?

Dr. **Miller**. I saw the story and I was dismayed because a discussion had been underway for some time about a supplemental for IRS on the question of auditors and IRS agents for reasons having to do, among other things, trying to avoid the problems that we had faced with the examiners a year or so ago, with returns being delayed unusually—some refunds and processing problems. That had been along a separate track.

It was not for the purpose, as I read, contrary to the report in the Wall Street Journal, it was not for the purpose of making up for the Gramm-Rudman question.

Senator **Lautenberg**. So you do not indicate that a supplemental for IRS or any other particular function is contemplated at this time?

Dr. **Miller**. Yes, I do.

Senator **Lautenberg**. You do?

Dr. **Miller**. Yes.

Senator **Lautenberg**. Where might that be directed?

Do we have a second, Mr. Chairman?

Chairman **Domenici**. I did not hear the question.

Senator **Lautenberg**. The question was whether Dr. Miller had knowledge of some supplemental requests that might be coming along? And he said that he did.

Chairman **Domenici**. And what was it you wanted?

Senator **Lautenberg**. I wanted to know what the substance of that supplemental would be. Do you know?

Dr. **Miller**. I have not approved it yet, and my people are working on it, but I only know they are working with Treasury on this and I only understand the broad dimensions of it, but it was on a track before Gramm-Rudman.

But again, it would probably relate to a portfolio of activities by the Internal Revenue Service, not just to auditors or just to agents.

Senator LAUTENBERG. All right. Thank you, Mr. Chairman. Thank you, Dr. Miller.

Dr. MILLER. It would not be a lot of money.

Chairman DOMENICI. Thank you very much.

Senator Gorton.

Senator GORTON. Mr. Miller, as this year proceeds, you are not likely to garner a great deal of praise. I want to say to you now, how very favorably impressed I have been with your first couple of months in this office. It seems to me that you and your two colleagues, the two other witnesses that will appear before us today, have done remarkably well under tight time constraints in meeting the requirements of Gramm-Rudman-Hollings, and in fact, how few very difficult questions and requests for change you have made of us.

You certainly began your career in this position in a first-rate fashion.

Dr. MILLER. Thank you.

Senator GORTON. In simply getting the three of your entities so close together on some of these estimates so that we can avoid some of the bitter and often destructive debate we have had in this committee is a signal accomplishment for which you deserve praise.

I want to follow up on Senator Lautenberg's question. Maybe I am missing something entirely, but even after this $11.7 billion sequester, the budget deficit for fiscal year 1986 will be much in excess of what we had determined it should be.

REQUEST WOULD HAVE POSITIVE REVENUE IMPACT

How can you ask the Congress for a supplemental appropriation of 1986 funds, which will automatically at its first dollar increase the deficit above the legal amount further?

Dr. MILLER. Well, let me say, one of the things that we want to do is to maintain the integrity of our tax system. But beyond that, in a very narrow framework back to the kinds of questions that predicated Senator Moynihan's question, vis-a-vis the budget deficit, the hiring of these additional, some of these additional people would mean the increased collection of receipts, so that it would not have a negative impact on the deficit.

Senator GORTON. OK, so you feel that you can legally make a supplemental budget request for an activity which will have a direct and positive revenue impact?

Dr. MILLER. Very good question.

No, no, I am not nearly so clever as that, Senator Gorton. As you may or may not know, 1986 does not require 1-for-1 offset for supplementals, 1987 and beyond do.

That is my understanding of the law, and I may be incorrect.

Senator GORTON. All right.

So, for this year, at least, you have the authority to ask for a supplemental for whatever purpose——

Dr. MILLER. Yes.

Senator GORTON [continuing]. Even though it would increase the deficit and would be invalid in future years?

Dr. MILLER. Right.

My understanding, if I read correctly Gramm-Rudman, for 1987 and beyond though, that the scenario that you were asking me, namely, could you go up for an IRS increase in IRS agents and offset that from a receipt, the answer is no, because you have to do the 1-to-1 offsets on outlays.

Senator GORTON. Thank you.

NOT ALL CONTRIBUTED FUNDS EXEMPT

This second question is more technical. I understand that in framing the budgetary base for the sequester order, both the CBO and OMB exempted spending from contributed funds. I am told, for example, that spending in the rivers and harbors contributed funds account, which comes from voluntary contributions from localities toward the financing or Corps of Engineer water projects was fully exempted.

Yet, on the other hand, money which NASA collects in its shuttle account, from the private companies that pay for the use of the shuttles, and which seem to be contributed funds, are not exempted, as I understand it.

Can you explain the rationale for the distinction in the treatment of these two seemingly quite similar activities?

Dr. MILLER. As you know, the act says that the following budget accounts and activities shall be exempt activities, and this lists activities resulting from private donations, bequests or voluntary contributions to the government.

Now, as why NASA contributions were not exempt, I do not know. I would have to——

Senator GORTON. Payment for services rather than voluntary contributions, is that the distinction that you are attempting to make?

Dr. MILLER. I understand that there are very few contributions, that the NASA moneys are offsetting receipts. I would like to get back to you in writing on that, if I could, Senator?

Senator GORTON. OK.

[The following was subsequently supplied for the record by OMB:]

The Government-wide policy in implementing the 1986 sequester is that the use of offsetting collections from non-Federal sources is sequestrable, for sequestrable programs. The law explicitly states that collections shall not be reduced; the policy does not violate that provision. Typically, when collections are received by an agency and then used to finance programs of the agency, budgetary obligations are incurred. These obligations are by definition a type of budgetary resource and therefore are part of the sequestrable base of resources.

The policy was confirmed by GAO before it was applied by OMB and CBO, and applies to NASA as well as any other Federal program with non-Federal collections.

Senator GORTON. One other question of a more or less technical nature, under a sequester order, Gramm-Rudman-Hollings requires an across the board sequester of all accounts unless they are specifically exempted. This means cuts in a number of programs which have permanent appropriations which operate without annual limits. The larger of those might well be the Postal Service.

How do you go about enforcing cuts of that nature?

Dr. **Miller**. Well, I am apprised that there are some discussions among lawyers going forward on this very point. We anticipate that they will abide by the law.

But what the lawyers conclude, I do not know what to tell you. We will get back to you when the lawyers conclude their discussions.

Senator **Gorton**. Thank you, Dr. Miller.

[The following was subsequently supplied for the record by OMB:]

For programs with permanent appropriations we first determined what portion is exempt from sequestration and what portion is used in a way that is sequestrable (for example, administrative expenses).

In the case of the postal service, it was determined that $1.2 billion is for administrative expenses and is therefore sequestrable in 1986.

It is up to each agency to enforce the automatic reductions (4.3 percent for sequestrable nondefense funds in FY 1986) required under Gramm-Rudman-Hollings. This requirement is being carried out faithfully.

Chairman **Domenici**. Senator Sasser.

Senator **Sasser**. Thank you, Mr. Chairman.

Dr. **Miller**. I want to welcome you before the committee today and I expect we will be seeing a lot of you before the committee in the coming months, and have, I hope, some very productive exchanges.

Mr. Chairman, before I begin, I want to commend and congratulate you on the excellent article that appeared yesterday in the Washington Post. I thought that article was insightful and very accurate in detailing how we got to the present situation and I want to pledge to you today, my support so that we will not have to live through that dismal scenario that you discussed at the end of your article. I would also like to say a word here for Gramm-Rudman-Hollings.

Clearly Gramm-Rudman-Hollings is not the most desirable instrument nor would it be my instrument of choice, in trying to do something about the budget deficit. But it does, I think, force all parties to come to the table, including the President, and I think that is its saving grace. I think it does force us, at long last, to face up to the consequences of a continually accumulating deficit. So, while it is not a perfect instrument and it is unfortunate that we had to come to this point, we did and here we are.

PRIVATIZATION CONCEPT TO BE USED

Now, Dr. Miller, there have been numerous articles and increasingly speculation lately, which comment on the proposals that will be contained in the President's budget, which he will submit to Congress in early February. This speculation, indeed, what I suspect may be some leaks, suggests that the President's 1987 budget will involve extensive use of the concept of privatization.

And I assume that there is nothing in Gramm-Rudman that would prevent the administration from using privatization, that is sale of certain Government assets, to try to reduce the deficit in order to meet the Gramm-Rudman deficit requirements. Is that the way you interpret it?

Dr. **Miller**. Yes, sir.

Senator **Sasser**. In other words, if the Federal Government wished to sell off an asset and realized gains from the sale of that asset, that could be applied to reducing the deficit in Gramm-Rudman?

Dr. **Miller**. Yes, sir.

Senator **Sasser**. Just as a spending cut or a revenue increase could be?

Dr. **Miller**. Yes, sir.

Senator **Sasser**. All right, sir.

Can you tell us, Dr. Miller, what programs or what assets might be included in the President's definition of privatization?

Dr. **Miller**. No, sir.

Senator **Sasser**. Are you going to give us that information at a later date?

Dr. **Miller**. Yes, sir.

[The following was subsequently supplied for the record by OMB:]

Over the past 50 years, the Government has expanded without any clear criteria for determining which activities it should undertake and which it should not. At the present time the Government is engaged in many activities that are similar to, or even the same as, those provided by the private sector. This year's budget proposes to return the following activities to the private sector:

The administration is proposing to sell the Power Marketing Administrations (Bonneville, Alaska, Southeastern, Southwestern, and Western Area), the Naval Petroleum Reserves (Elk Hills, California, and Teapot Dome, Wyoming), and General Services Administration (GSA) surplus property.

The administration is proposing to terminate Federal subsidies to Amtrak and for land remote sensing satellites (LANDSAT).

The administration is proposing to change the Federal Housing Administration (FHA) single-family mortgage insurance program, and to develop plans for selling FHA to the private sector; to charge insurance companies for services offered by the Federal Crop Insurance Corporation (FCIC), and phase out Federal subsidies for crop insurance; and to privatize the provision of political risk insurance by the Overseas Private Insurance Corporation.

The administration is proposing to convert from new housing construction subsidies to a housing voucher approach, and give the parents of children who participate in federally supported compensatory education programs the option to receive an education voucher which could be used to help pay for the education that best meets the child's needs.

The administration proposes substituting an interest rate subsidy program for the Export-Import Bank (EX-IM) direct loan program.

Chairman **Domenici**. You should since it is in your budget.

Do you not think so, Senator?

Senator **Sasser**. I think he ought to. I suspect he will.

Dr. Miller, how much can be raised, in your view, by moving in the direction of privatization?

Dr. **Miller**. Senator, I, with your indulgence, would be more than happy to discuss that at a later date, when we do discuss the 1987 budget I think to speculate about those issues right now, might communicate information or might be imputed to apply to the 1987 budget in ways that I simply want to avoid.

Senator **Sasser**. Well, let me just ask you this question. I think that you probably can answer it. Do you think that the move toward privatization will be a substantial portion of the administration's efforts to comply with the Gramm-Rudman deficit reduction requirements in the 1987 budget?

Dr. **Miller**. It will not go without notice, Senator, but it will not comprise the majority of the savings, by any length.

MOTIVATIONS FOR PRIVATIZATION

Senator SASSER. Well, is this movement toward privatization motivated primarily by the economic considerations that is, to realize the funds from the sale of the assets, or is it motivated primarily by philosophical considerations where in the philosophy determines that there are certain things that government ought not to be doing and let us get the Federal Government out of that and sell off this asset and realize a gain from it?

Dr. MILLER. Well, I am reluctant because it is premature to talk about the 1987 budget.

But on the generic issue, let me address that. Ordinarily, there would be two motivations for the so-called privatization. One is a philosophical cut, as you say.

Some people would say, well, this is the kind of activity that does not belong in government or the Federal Government. It ought to belong in the private sector.

Second, there is a broad literature which scholars have reviewed, the effectiveness of government enterprises and many times found enterprises that, comparable enterprises in the private sector and compared the two and almost invariably concluded that those same, or the analogous enterprise in the private sector performed better, responded better to consumers than the enterprise as constituted in the Federal Government.

The reason mainly being related to the set of incentives. So, one could say, either a philosophical reason or trying to achieve the best use of those resources would justify privatization.

But, as you well know, Senator, 1986 and 1987 and perhaps a few years beyond that, we need the money and privatization, that adds a third dimension or really a third rationale for privatization.

Senator SASSER. Well, my time is up.

One final question. I would like to argue this point at some length, but I know I cannot, Mr. Chairman.

Dr. Miller, with regard to the Tennessee Valley Authority is that on your list of projects to be sold?

Chairman DOMENICI. Privatized.

Dr. MILLER. Senator, I wish very much to respond, I do not wish to be evasive, but the dimensions of the President's budget will become, the precise dimensions of the President's budget will become known when he issues it on February 4.

Senator SASSER. Well, as we used to say in the courtroom, Mr. Chairman, he does not deny it.

Thank you.

Chairman DOMENICI. Let me just say, Dr. Miller, that I do not think we will press the issue. I understand that you will appear before this committee on the 4th as one of your first congressional appearances with reference to the budget. And I assume that Senator Sasser and others, who are interested in the scope of privatization, will certainly know the details in advance so that you can be questioned with reference to privatization at that time.

Let me just raise another question before I go on to the next Senator.

NEUTRAL SUPPLEMENTAL APPROPRIATIONS

You indicated that with reference to supplemental appropriations that the administration, was of the opinion that while in 1987, supplemental appropriations would not be in order if they exceeded the maximum deficit, that this restriction did not apply in 1986?

Is that your opinion?

Dr. **Miller.** That is my understanding.

Chairman **Domenici.** And you got that opinion from your lawyers, perhaps?

Dr. **Miller.** That is what I recollect. They may have told me something else and I remembered it wrong. Let me see if I can check it.

Chairman **Domenici.** I am not talking now about a point of order because you have already exceeded the deficit, which is an old law.

It seems to me that under the new one, there is no year stated. It says, with reference to that, it shall be neutral in terms of outlays with refernce to a budget. It does not say 1987. Maybe you all can check that.

At least let me say that I think that it is the case. If you do not mind checking it further and stating your opinion for the record, I would appreciate it. I do not want to leave you with the idea that you may be able to send one up here and have us tell you it must be neutral. I think that we have to get it answered.

Dr. **Miller.** Let me just say, first, I may be incorrect on that. The second thing, we may ask, we may propose offsets as well.

Chairman **Domenici.** You may have to.

Dr. **Miller.** Whether we have to or not, we may do it anyway.

Chairman **Domenici.** All right, I just wanted to clarify that.

Senator **Sasser.** Well, we think that you have to.

Chairman **Domenici.** That is your interpretation?

Dr. **Miller.** You may be correct.

[The following was subsequently supplied for the record by OMB:]

Supplemental appropriations for 1987 that exceed the maximum deficit amount must be offset, so that the rsult would be deficit neutral.

It is our understanding that this does not apply to 1986, although it is likely that offsets would be proposed.

Chairman **Domenici.** Let me proceed then, to the next Senator. As I remember, Senator Riegle was next.

Senator **Riegle.** Mr. Chairman, I think that is right, although I do not know that Senator Chiles has yet asked a question.

Chairman **Domenici.** He understands that he can proceed at any time.

Senator **Riegle.** Very good, thank you.

LINE DRAWN AGAINST TAX INCREASES

Let me ask you this, Dr. Miller, in reading today's newspapers, it was reported that in a meeting yesterday that the President had with Republican congressional leaders, that the President drew the line against any tax increases and said, defense spending increases are essential and when Larry Speakes was questioned about this, he said and the quote that is in the paper is, that if anybody doubts that, well, they are wrong and the President says that he is going to prove it.

Is that an accurate reflection of the President's view, in so far, as you understand it, as the Budget Director?

Dr. **Miller**. I was there. Without commenting on specific words that the President said in a private meeting with the Republican House and Senate leadership, which I think would probably be inappropriate, I would say that it accurately conveys his views.

Senator **Riegle**. So, I am not asking you to say this in advance of the budget document, coming out on the 4th of February, but I assume then, and everybody is working on the operating assumption that there will be no tax increase in that, consistent with what the President said yesterday that the defense increase is going to continue to be advocated.

I take it that that is a reasonable expectation, is that right?

Dr. **Miller**. Yes, indeed.

Senator **Riegle**. Now, later on, down in the same story, our own chairman of this committee is quoted, Senator Domenici is quoted, as saying, that it cannot work that way. In fact, you have read the article, so that I will not restate it all, but Senator Domenici is quoted to this effect, that he predicted a compromise saying, "There will be defense coming down a little bit, some revenues, domestic reform, and we will get to $144 billion"—which is, of course, the deficit target. Asked if he had been encouraged by the President to accept a compromise, expect a compromise, he said, "No, he did not, but it will happen."

So, obviously the chairman of the committee and the President, at least as of yesterday and presumably today, are very much of different points of view on this, as it is a matter of public record.

And you, in fact, just confirmed with respect to where the President is.

I want to relate that to your colloquy with Senator Moynihan, where you were talking about, for the coming fiscal year, in terms of getting down to the $144 billion target. That we are going to have to take something on the order of $55 or $60 billion, roughly, out somehow, in order to get from roughly $200 billion deficit down to the $144 billion deficit as the law requires.

And you recall that discussion with Senator Moynihan?

Dr. **Miller**. Yes; I do not think that I confirmed those figures precisely, but——

Senator **Riegle**. Well, are you comfortable with that estimate or would you like to revise it? I would like to use a number that you think is more accurate.

Dr. **Miller**. I think that lawyers have a term, arguendo, arguendo, choose a number.

Senator **Riegle**. Well, it is more than $50 billion, presumably to get down to the $144 billion. We have got to do a lot of cutting.

Dr. **Miller**. I would be happy to assume your figure of $60 billion.

Senator **Riegle**. All right, well, let us say that it is $50 or $60 billion, it is in that range.

Dr. **Miller**. Yes, sir.

GOVERNMENT WOULD BE LIQUIDATED

Senator **Riegle**. Now, if the President holds to his view, no revenue increases and the defense buildup has to continue, then we are not going to be able to get to the package deal of the kind that Senator Domenici has talked about, and we are in the same impasse that we have been in and then we are back in sequestration. That is the outcome if there is not some sort of agreed-to package. We all know that.

Now, as you were talking about sequestration, which most people hope that we do not get to, but we are about to get to it for the current fiscal year, we are about to see it happen. If that happens, we have to take out the $50 to $60 billion with sequestration and that comes out according to the Gramm-Rudman formula, and it comes out roughly half and half, defense, nondefense, from the totals that are in your statement of about $214 billion as the base. It seems to me that if we take out, if sequestration is what is going to happen in 1987, and if the same impasse holds into 1988, and beyond, it seems to me that in order to get down to the balanced budget or to take out the bites in the following years, we are going to have to, under sequestration, take them out of the same remaining pot, defense and nondefense money.

And in rough numbers, basically what happens, if you take that through to the end—if you go out to the balanced budget out in 1991, and the impasse remains, or at least it remains as long as Mr. Reagan is President—you are on a track where you are basically going to do away with all of that part of government. That defense would disappear and nondefense would disappear in terms of those areas that are now reachable by Gramm-Rudman and you know, interest on the debt would presumably continue to be paid, but in effect, you basically liquidate the rest of the Government. Sort of the same way you are talking about the fire sale on assets that apparently is going to show up in the new budget.

And I am just wondering, you know, if we are going to go down that route. I am not sure that the public yet understands that those are the consequences of what happens if these automatic cuts continue, as they are about to start, for fiscal 1986, if they continue into 1987, 1988 and 1989, based on this impasse on not being able to put some other kind of a package together. Is that not effectively going to eliminate, you know, those two categories of government as we generally define them?

I mean, would they not in effect, disappear?

Dr. **Miller**. Well, Senator, those are a string of ifs, that I just do not believe that Congress will see happen.

I do not believe that Congress would see the national defense ripped apart.

Senator **Riegle**. I would hope not.

Dr. **Miller**. I do not believe that Congress would see others, and the domestic areas that are subject to sequestration, ripped apart. So, I do not believe that we will have the series of sequesters that you hypothesize.

Senator **Riegle**. Yes, but that requires a big if on your part. And the if, in your response is, and that is, if the Congress and the President somehow come up with a package.

But earlier you said, you are bound by the law, and the way the law reads today, is that not what the law, according to Gramm-Rudman, would mandate, absent some kind of a new answer?

Dr. MILLER. Well, at any point in time, you have got to have authority and appropriations for any program. But those kinds of programs that are subject to yearly appropriation, they run out at the end of the year, there has to be some congressional action. Are they—is Congress going to restore the budget authority, or is it going to start at the level of budget authority reflected in the sequestration?

I do not know. I would presume the former, not the latter, in which case, this series of sequesters, the set of assumptions would fall, the conclusions would fall, it seems to me.

AX WILL FALL WITHOUT A PACKAGE

Senator RIEGLE. Well, here is the bind that you are in and we are all in together and that is that the law of the land now requires that we hit these absolute deficit targets in each of these following years. And there is really no leeway and there is the automatic ax that falls in terms of the sequestration. If we cannot work out a package deal, which the President yesterday said no to, and the chairman and the committee would like to see, if we stay in that impasse, where we have been now for 5 years, exactly what you have just said, what no one wants to see, and what the law requires will happen. In other words, in fact, by law, if you were still the Budget Director, will you not be mandated to come in here and tell us how to make the cuts? Well, assuming that we are into sequestration, will you not have to help carry out those automatic cuts, if sequestration takes effect in 1987, 1988; will you not have to do that? Are you not bound by the law to do that?

Dr. MILLER. Well, I would surely share some views about the matter with you, but what I am saying, Senator, is I believe that your conclusion is based on an unrealistic set of assumptions.

Let me——

Senator RIEGLE. But that is what the law says. In other words, absent some new policy, is that not what the law, Gramm-Rudman, now mandates?

That is what will happen automatically by law, if there is not a compromise found?

Dr. MILLER. No, sir.

If I could be allowed just a moment to explain. Even, let us assume that we enter, we go through all of 1986, and we even enter in 1987 with a continuing resolution, that is based on current services, and then we sequester $60 or $50 billion, your assumption, and then we arrive at the end of the fiscal year 1987 and go into fiscal year 1988, well for these accounts that are subject to sequester, at the end of 1987, there would not be an appropriations measure, unless Congress had passed something.

Unless the President had signed something, unless Congress had passed something and overridden the President's veto, and I do not think that Congress would responsibly push an appropriations measure for these sequesterable accounts that was down that far. I just do not believe that would happen.

Senator **Riegle**. Well, I am just not sure how we are going to end up doing the appropriations.

Chairman **Domenici**. Senator, your time is just about up.

MORE BANK EXAMINERS NEEDED

Senator **Riegle**. I thank the chairman. If I may, just in 30 seconds, say that I share the concern that others have expressed particularly with the FDIC and with the IRS, if we are going to be cutting—I am concerned about bank examinations, with a lot of banks in trouble, I do not think that we ought to be laying off bank examiners. I think that we are going to need additional ones and I would hope that as a responsible matter, that we would see some leadership not just from here, which we will try to give, but from your side as well on that.

Chairman **Domenici**. Thank you, Senator.

Senator Hollings.

Senator **Hollings**. Yes; thank you, Mr. Chairman.

Dr. Miller, let me join also not just in the welcome but in complimenting you on the outstanding job that you have done.

You appear, to me, to be a David Stockman with one set of books. You are just as smart as Stockman. I have never found anybody as clever as he was.

And as a result, that is why we are here. There is an old story about Uncle Earl, it is a long tale, about a lie. And well, we started off this time last year with just that, a lie. We had a split vote right straight down the middle of this committee, to not use your figures because no one trusted OMB. We played that charade throughout the year until August and we lied in August by the tune of *x* billion.

We knew it at the time. I have served 10 years on this committee, and also as the chairman, and there are few things I have regretted during that time as much as having to vote against that budget in August. But I had to because we had just gone into a charade with everybody using these false figures.

That is why we are caught up in this so-called cut here in February—because we knew we were really not telling the truth back in August.

In that line of thought, there is no reason to think that the 4.3-percent cut means we are going to drop planes out of skies, or eliminate the Customs Service, or pull the plug out of law enforcement.

FREEZE WOULD HAVE MADE CUT UNNECESSARY

The truth is that I have not gotten the exact figures, but the $105 billion from which you are going to have to cut 4.3 percent actually reflects a 4-percent increase made back in August for this 1986 fiscal year.

So, if we had gone along with the freeze that my distinguished colleague from North Dakota and I both sponsored, we would not have to have that 4.3 percent cut. Do you see what I mean?

It is when you come back and cut from the increases that all of a sudden the planes are going to fall out of the sky. The truth is that we have tried now for 4 years to hold the line on spending, an effort that has had substantial bipartisan support. And I am confident that we will not have that constitutional question about Gramm-Rudman-Hollings to deal with if you continue on and give us a similar budget here in 1987. With the true figures, I would not mind transferring this authority to OMB and get by that particular executive branch constitutional hurdle.

But the reason for it, is because of that office of yours and your predecessor. We knew that he was smarter than we were, and therein was our dilemma.

Now, let me congratulate Senator Domenici. He has laid out the record, in his Washington Post article, and he has sort of set a scene whereby shalom, we can have peace and we can develop an environment to get this thing to work or, alternatively, we can go back to planes falling out of the sky and the end of the farm program and everything else.

Now, the truth is that we have to address revenues. I want to give the President a chance. We all know his position on revenues. Since I said that I did not see how you could possibly cut the deficit without revenues, in the debates all last fall, the question has been of a confrontational nature. The President and the Congress are going after each other in a game of chicken—who is going to recommend taxes first?

Mr. Miller, we recommended those revenues, in a proposal in December, in those debates. I outlined a freeze budget again for the 1987. Look at it. If you put an oil import fee, a minimum corporate tax, or if you freeze tax expenditures, you can still give an inflationary increase to defense and you would not have to cut all of these programs. It is not all that difficult and we will be proposing such a plan—I hope in a bipartisan fashion, not just here in the Senate, but in the House and the Senate. We should do this no later than the end of February or the first part of March, so that we will not have to wait for the catastrophe, the train wreck, or the political game of "I told you so."

Gramm-Rudman-Hollings comes only as a result of our not doing the job, of our trying to fool the American people. Congress voted for it, because we knew that we could do exactly what the Governors are doing back in the State capitals balancing their budgets.

Two weeks ago, the State of South Carolina discovered it had overestimated the revenues back in July. So, the Governor of South Carolina made a 2-percent cut across the board. That same procedure applies in 42 other State capitals. If it can fly in Columbia, SC, why not in Washington, DC?

That is all that we are doing.

TRUE REVENUES NEEDED

On the matter of revenues, look at those figures now and do not play a game. If you have integrity you will have our trust and we can work together.

The fiscal year 1987 budget will reach $1 trillion. It is $200 billion for Social Security; it is $200 billion for interest on the debt, that is $400 billion; it is $100 billion for health; that is $500 billion; it is $300 billion for defense; that is $800 billion and we are running at a $220 billion deficit, so you can just eliminate everything else; you do not have to just cut TVA or sell it or whatever else. I mean just eliminate the rest of Government and you have still got a $220 billion deficit. So, you are looking at the need for some kind of revenues and not any nominal gains from something like user fees. We need some true revenues and a minimum corporate tax, some kind of oil import fee.

We thoroughly compliment you because you have worked around the clock. And in fairness to you, I acknowledge that you raised the constitutional question about CBO that Sunday afternoon when we were over on the Senate Chamber side. We were using solely CBO and you raised the constitutional question. You raised it before we even passed the amendment in the Senate. And it is a real question.

We think that we have corrected that, with the best of the constitutional opinion by saying that CBO and OMB recommend to an executive branch appointee; namely, the Comptroller General.

I am already over my time, but there are a lot of other things to get into the record, to clarify some of this thinking, but I do compliment the Director of OMB and I compliment our distinguished chairman.

I think that if we can start off at the pace and attitude that Senator Domenici set in that particular article, we can get this job done. Yes, we did it for Social Security because we increased the taxes for Social Security. And now, anybody else who wants a COLA, I will be glad to increase their taxes and give it back to them, that is all that we did.

And do not start all of that pressure that they are giving us around here about what we cut. We have not cut anything. We are paying the bills, instituting truth in budget, and playing the game of truth or consequences. Either we begin to start telling the truth to the American people about this budget or we are going to pay for the consequences with Gramm-Rudman-Hollings.

Thank you, Mr. Chairman.

Chairman **Domenici**. Thank you, Senator Hollings.

I have kind of a wrapup for myself here, but do any other Senators want to ask any additional questions?

Yes, Senator Grassley.

COMMODITY CREDIT CORPORATION

Senator **Grassley**. I want to visit with you about Congressman Smith's amendment in regard to the Commodity Credit Corporation.

This amendment, I think, I do not know exactly what it said, but implicit in it was any contract signed by March 1, with the ASCS farm program would be honored and not affected by Gramm-Rudman.

Now, the USDA has evidently decided that there would be no signup until starting March 1. I want to know whether there has been any communication with OMB and USDA on that March 1 date?

What is behind the March 1 date? Is it an honest to goodness impossibility on the part of USDA to get the farm program operational before March 1?

Or, is there some sort of subterfuge to see that no farmers have their program under contract with USDA and then there is a larger share of Gramm-Rudman for domestic programs being paid for by agriculture?

It is my understanding that 20 percent of all the domestic savings in Gramm-Rudman will come from the U.S. Department of Agriculture.

Dr. MILLER. Well, I cannot comment on that figure. I do not know what the appropriate figure is.

As to the March 1 date, I do not know whether there has been communication between OMB and the Department of Agriculture on this or not. I will find out and to the extent that I can, I will let you know.

Senator GRASSLEY. Do you have anybody here that specializes in agriculture, someone who you could confer with to respond to my question?

Dr. MILLER. No; not here.

Chairman DOMENICI. Can you get the answer, Mr. Director, and furnish it to the committee, so that the Senator will have a response?

Dr. MILLER. I will be glad to.

We will have it soon.

Chairman DOMENICI. Yes, please.

[The following was subsequently supplied for the record by OMB:]

Gramm-Rudman requires the Commodity Credit Corporation to treat all participants in a given crop year equally. Given the clear statement within the Conference report that commodity programs receive the same treatment as other government agencies, compliance was scheduled to begin with the 1986 crop.

The timing of program announcement is a separate matter. Both OMB and USDA have attempted to expedite these decisions as much as possible to give farmers more information upon which to base crop decisions. The 1985 Farm Bill is a complex piece of legislation that did not take final form until late last year. Ensuring the most efficient, cost-effective program possible has taken much time and effort. However, I can assure you that we have and will continue to make announcements as soon as possible.

Senator EXON. Deficiency payments will be paid out as I understand it over a period of months and the total deficiency payments for the crop year 1986, very likely will go over into fiscal year 1987.

I ask this question, under that kind of a scenario, would a farmer, is a farmer running the risk of having part of his 1986 deficiency payment sequestered once by 1986 action and a second sequestering by the next fiscal year 1987 action?

Dr. MILLER. I doubt it, but I will be glad to give you a later response on that.

Senator EXON. Thank you, Doctor.

[The following was subsequently supplied for the record by OMB:]

Section 256(j) of Gramm-Rudman requires the CCC to treat all products within a given crop year equally. CCC outlays are sequestered on a crop year rather than a fiscal year basis; therefore all cash payments from the 1986 crop will receive an equal 4.3 reduction even if they are not made until fiscal year 1987. On the same principle, all cash payments from the 1987 crop year will fall under the 1987 sequester order should there be one.

Chairman DOMENICI. Thank you very much.

Senator Johnston.

DELETE MAJOR PARTS OF RECONCILIATION PACKAGE

Senator **Johnston**. Dr. Miller, on reconciliation has been referred back to the committee, and I do not know whether it is going to be possible to get that committee going or not in view of the threat of a veto from the White House.

Is the White House still implacably opposed to reconciliation or is some compromise possible, and if so, along what kind of framework?

Dr. **Miller**: The reconciliation measures that were before the House and the Senate were unacceptable to the President.

There are several major issues that I communicated over a number of occasions that stand in the way of a reconciliation measure that is acceptable to the President. I think there are reasons to talk about some of these issues, but mainly it is a matter of, I think, deleting some major parts of the reconciliation package.

As the President has indicated, he views, he is very much in favor of reconciliation but wishes this to be a time of saving money rather than introducing policy changes that might not stand on their own feet.

Senator **Johnston**. Well, specifically with respect to 8(g) are you talking about deleting 8(g) altogether, or are you talking about compromising with respect to 8(g)?

Dr. **Miller**. I would be willing to look at any ideas that you might have, obviously, this is a matter that has been in the courts and needs to be resolved in some way, but the 8(g) provision that was in the earlier legislation was not acceptable.

Senator **Johnston**. Well, do you plan to use 8(g) revenues in your budget in fiscal 1987, if we do not do it in reconciliation?

Dr. **Miller**. I would reserve, Senator, with your permission, judgment on that, or answering that until the budget, the President's budget appears.

Senator **Johnston**. Well, I would suggest to you that you probably will and I think that issue and other issues ought really to be resolved in reconciliation and I think that there are frameworks for resolving those issues.

I mean sooner or later you are going to have to face up to them and I hope that, I wish that we could do it sooner rather than later.

Dr. **Miller**. I agree with that. I do not think that we would be in a position of simply holding back reconciliation in order to make the 1987 numbers look good. That would not be our policy.

QUICK ACTION CONTEMPLATED ON RECONCILIATION

Senator **Johnston**. Well, as you know, we would have to get moving pretty fast on reconciliation. I think that some kind of signal ought to be given by the White House to go or not to go and if so, according to whatever your matrix is.

Chairman **Domenici**. Might I answer that please?

Senator, we have conferred with the White House on it and basically all the controversial issues except 8(g) are in the jurisdiction of the Finance Committee and the Ways and Means Committee.

The distinguished chairmen here and over on the House side, are aware of the controversies and the White House's position and are contemplating further action. The reference of the 8(g) back to the appropriate committee, which is Energy for starters on this side, will be done very soon. They are talking with the chairmen of the respective committees and I have been talking to the chairmen asking that they please move quickly because we will lose the reconciliation bill if we do not.

I believe that is a fair statement of where we are at at this point.

Senator JOHNSTON. OK, thank you.

Chairman DOMENICI. Let me say this, Senator Symms has some written questions and we are going to submit them with other questions and you can answer them.[1]

I want to make three observations and then I will not ask any questions.

ACCOUNTS SEQUESTERED

I had three generic questions about the process but I will ask them of the other two witnesses because I understand that with reference to programs like NASA and space shuttle launches where you have private communication firms paying we have sequestration of the account. And that goes for a number of programs, such as uranium enrichment, Customs processing, patent and trademark, and meat and poultry inspection, where the outside pays in, yet we have sequestered the account, in terms of perhaps restraining the service, yet receiving the same amount of money from the private sector.

There is another—the FDIC issue and as I understand, that too, is generic, everybody is treated the same. And you all have come up with an approach where the administrative costs are being sequestered in spite of the fact that all of the money comes from outside. But it was either do it that way for all or a few would be treated differently because they were appropriated.

But we will need some testimony from the others on that and if it is not totally to the satisfaction of the committee, we will ask you to answer those questions so that we will understand the issue.

It could be corrected if Congress desires. Perhaps the result is not what we want now, but nonetheless, I think that it is pretty clear that it is what we intended.

[The following was subsequently supplied for the record by OMB:]

Gramm-Rudman-Hollings instructs us to exclude offsetting collections from non-Federal sources from the sequestrable base. However, payments financed by these collections are included in the sequestrable base for sequestrable programs. CBO and GAO concur with this approach. Typically, when collections are received by an agency and then used to finance programs of the agency, budgetary obligations are incurred. These obligations are by definition a type of budgetary resource and therefore are part of the sequestrable base.

Section 256(b) of Gramm-Rudman-Hollings requires that Federal administrative expenses for exempt programs and programs subject to special rules be included in the sequestrable base of outlays.

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[1] See written questions to Dr. Miller and the responses, p. 107.

Chairman DOMENICI. Last, by way of observation, let me say that I firmly believe that when you consider the thousands of accounts with very, very different approaches to funding our Government, everything from pure entitlements to forward funded programs that are appropriated, that the staff that serviced the conferees from the House and Senate did a marvelous job and in turn, the conferees approved a pretty good bill. There are very few discrepancies in terms of serious concerns and most of those are generic. But when you consider the amount of money involved, it is not very much and frankly, I do not think that it could have been handled any better.

Let me also compliment the GAO. I think they have done a wonderful job and I do believe the law is going to be held constitutional on that point, the point of whether the GAO is executive or legislative. I do feel that if it is not, there is an expeditious way for Congress to handle it. It might be cumbersome but I think that it could get done.

SEQUESTRATION INTENDED TO BE TOUGH

With reference to taxes, I just want to make one point. Clearly you represent the President. I am not the President, but we are going to try our very best to give your budget a full hearing, and I have told you that many times. We are not here to shoot it down, but what we are here for is to attempt to reach a budget and a process and an accommodation that will reduce this deficit in an orderly manner down to $144 billion. Nobody who voted for Gramm-Rudman thinks that the sequestration that may occur in August is orderly. It was not intended to be, it was not intended to be good policy. It was intended to be tough, onerous, rather arbitrary but to have a constitutional way to diminish the outlays of this Government in a reasonable manner in a sort of "or else" sort of approach.

I believe that while it is in that respect, Draconian, it clearly serves a purpose. Everybody in the Nation understands what is going to happen if we do not reduce the deficit ourselves.

For those who think that if Gramm-Rudman was ever carried out and brought into play, the sky would fall in, let me tell you that I have concluded that that is absolutely ridiculous. Anybody that thinks that would have to conclude that the only way that their program would be funded, including the defense of our country, is if we have deficit spending and to have it in an exorbitant manner and I think that is a ridiculous approach. Our country should approve those things that we need and pay for them. And for one to assume that there will be no environmental protection or defense unless you have deficits is absolutely ridiculous.

My last observation has to do with taxes and since you are an economist, I will share it with you, I really have a lot of difficulty understanding the rationale that says, $25 or $30 billion in taxes, new taxes, judiciously enacted, will destroy the economy, but tax reform that switches $150 million in new taxes to business—new, in the sense that they were not there yesterday and they will be there 2 years from now—is perfectly fine. I do not expect an answer, I just want you to know that I do not think that is very logical and I think that there is no empirical evidence that says that it is.

So, I am not terribly worried about saying that there will have to be new revenues because I think that tax reform is a dramatic imposition of new taxes where they do not currently exist. In the macro sense, one could argue that it is neutral but I think in the practical economic sense, it is far from neutral.

Now, unless there are other questions, we are going to thank you.

Senator MOYNIHAN. Mr. Chairman, one technical.

Chairman DOMENICI. Sure, one technical question.

REVENUE COLLECTION

Senator MOYNIHAN. If I could say, Dr. Miller, in the sixth technical problem that you identified, had to do with revenue collections for Puerto Rico, Guam, and the Virgin Islands, and that is a continuing concern of the Finance Committee, as you could imagine.

Could I ask that you give us a note on what is involved and what you would recommend?

Dr. MILLER. OK, I would be glad to.

Chairman DOMENICI. Thank you.

[The following was subsequently supplied for the record by OMB:]

The Internal Revenue Service account "Internal Revenue Collections for Puerto Rico" is a depository for IRS-collected excise taxes on behalf of Puerto Rico. Excise taxes collected under the Internal Revenue laws of the United States on articles produced in Puerto Rico and either transported to the United States or consumed on the island are paid to Puerto Rico.

The Customs Service, "Miscellaneous Permanent Appropriations" account operates in nearly the same manner. Customs duties, taxes and fees are collected in Puerto Rico and deposited in this account. After administrative expenses are paid for, the remaining amounts are transferred to the Treasurer of Puerto Rico.

The Department of the Interior "Payments to the United States Territories, Fiscal Assistance" account provides remittance to Guam and the Virgin Islands of certain revenues collected by the Internal Revenue Service (Public Law 95-348). Excise taxes, collected primarily on rum exports, are returned to the Virgin Islands. Guam is paid income tax collections of mainland personnel on Guam. Estimated payments are made in advance for the following fiscal year.

These accounts are, essentially, pass-through accounts where excise taxes are collected on behalf of the respective Governments and then returned to the Governments. In 1986 under the Gramm-Rudman-Hollings legislation, the IRS account will be reduced by $10.535 million, the Customs Service account will be reduced by $4.515 million, and the Guam and Virgin Islands payment account will be reduced by $2.580.

As noted in the prepared testimony, Congress did not except any of these revenue-collection accounts from sequestration. As a result, the Office of Management and Budget followed the law and subjected each account to sequestration.

Senator HOLLINGS. Could you elaborate on what you would recommend on any of those points, any and all of them?

Chairman DOMENICI. If you were to make amendments in the legislation?

Senator MOYNIHAN. Yes, sir.

Senator HOLLINGS. Yes; or whatever action you think would be necessary.

Chairman DOMENICI. Could we do it this way and satisfy the Senators? If, in fact, you think that an amendment would be necessary to fix something, tell us that, and if you see a problem, and give us your views——

Senator **Moynihan**. He has identified seven specific problems, so he told us.

Chairman **Domenici**. Tell us whether you think that they ought to be corrected and if so, how?

Is that a fair question to you?

Senator **Moynihan**. Yes; but let me say, if I could follow up on the point that you made earlier, one of the points that you made earlier. I, too, have found that the process has gone amazingly smoothly without anything like the glitches that one might have anticipated in legislation as comprehensive as this.

Chairman **Domenici**. I would have to compliment the process, the people who were involved in the process of putting this together, as well as my own people and those at CBO and GAO.

Frankly, the world would not fall apart if no changes were made at all. I am reluctant to suggest specific changes for concern that someone might conclude that we believe, or the administration believes, that Gramm-Rudman is somehow fatally flawed. That is not the case.

I think it is an important, appropriate remedy to an ongoing problem, and I think that it will work and work well.

Senator **Riegle**. Mr. Chairman.

Chairman **Domenici**. Yes, Senator.

Senator **Riegle**. I will be very brief, but I want to raise one more item and that is I want to first of all, quote the last paragraph of your op-ed piece in the Washington Post, which I would like to include in its entirety at the end of my comment here.[1]

But you conclude that by saying that if the Nation's leadership fails to agree by late spring on some sort of a compromise here on the budget, especially in a year charged with important elections, the mechanism of Gramm-Rudman-Hollings will take effect. To allow that to happen would be a national and even an international tragedy. And I agree with that exactly.

The problem is, today as we sit here, we are starting with the same impasse on putting that package together that we had last year and the year before that produced Gramm-Rudman.

TIMETABLE LIKE RIDING A BULLET

Now, here is what the timetable looks like and there has been no discussion of this yet, here today. We are going to get the budget from you in 13 days. And after we receive that budget we have got 70 days, which is 83 days from today, now, these are calendar days, by which the Congress has to complete action on the budget resolution. That is April 15, and that means that we have got to find a way to take the $50 to $60 billion out of the deficit, whether it is all with spending cuts, as the President has said, and presumably in that budget document is some kind of a package which the budget chairman and others, Hollings, and so forth, are recommending.

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[1] See the Ghosts of Deficit Forever, p. 142.

Then—it is like riding a bullet in terms of this timetable—the Congress has never ever met a timetable as swift as this one in terms of the magnitude of the decisions that have to be made. Not only do we have to have that whole package together and agreed on between the House and the Senate by April 15, but then, we have got 67 days after that, which is 150 calendar days after today, to enact the reconciliation bill, which is actually going to affect all of the cuts in terms of actually bringing the numbers where they are supposed to be and then 15 days, after that, 160 days from today, the House has to pass all the appropriations bills, and that is by June 30, 1986. I cannot remember the last time—I have been here 19 years—that the House passed all the appropriations bills ever, let alone by a date like June 30.

So, we are talking about here, riding a bullet in terms of the timetable in a way that is hard for me to imagine. So, when you say, there have been no glitches yet, it seems to me that there is a whole big set of glitches that are immediately in front of us. And my point in raising it is this, I agree with Senator Hollings that it is essential that the numbers be honest and that we have a relationship based on that kind of trust, in order to get something together here, but if the process of putting the package together is not just as honest as the numbers, then the whole thing is not going to work.

BUDGET SUMMIT NEEDED

And I think that those who have been suggesting that a budget summit of some kind is needed, are right. If the President stays frozen in his posture of yesterday and today, which you have confirmed here, and you are hearing from Senator Domenici and others on this side of the aisle that we are going to have to work out some different arrangement that is at odds with what he says, we have got between now and April 15 to get started and I think that we are going to need that budget summit meetng. I do not think that we can go through the normal process and get there in time. And I am just stating that from the point of view of some years of service on this committee, but I would ask you as a budget director to think about it yourself. Because if we are working with an unrealistic process that is not going to get this package together on the timetable that the law now requires, I mean we are all saddled by the same law, it seems to me at some point, you may have the obligation to say to the President, something that he may not want to hear and maybe it is time to have that kind of a meeting so that we can actually get this job done within these very confined timetables which, you know, are brand new.

I mean we have set timetables upon ourselves by law, that are just unimaginably difficult if we are going to try to do it with the same old game of here is a budget, everybody says that it is DOA and then weeks pass by before we really get down to the hard bargaining. I could hope that we could have a meeting of the kind that I am describing a week from now, 2 weeks from now, shortly after the budget comes out so that we can really have a realistic chance of hitting these timetables.

Chairman DOMENICI. Thank you very much.

Now, we are going to have testimony from the Director of CBO and the Comptroller General.

Chairman DOMENICI. Dr. Penner, we wanted to welcome you officially before we started, but you weren't here, and so I welcome you now again.

I don't think there's any need to do anything of a preliminary nature with reference to you, Dr. Penner. You've appeared here a number of times. As far as the Comptroller General, Mr. Bowsher, you've been here before, but in a much different capacity.

And let me just say on behalf of the committee that we welcome you both.

Dr. Penner, we are aware of your written remarks. They'll be made a part of the record. We hope you will summarize your testimony, and the same applies to you, Mr. Bowsher. We do have a few questions, but we'll make both of your statements part of the record, and we'll start with you, Dr. Penner, and then proceed to you Mr. Bowsher, and then we'll have questions of either or both of you.

You may proceed.

STATEMENT OF DR. RUDOLPH G. PENNER, DIRECTOR, CONGRESSIONAL BUDGET OFFICE

Dr. PENNER. Thank you, Mr. Chairman. It's a pleasure to be here today. I would like to reiterate what Dr. Jim Miller said about the working relationship between OMB and CBO in completing this very difficult project.

I think the two staffs worked together magnificently. They worked extremely hard, and deserve our thanks for that. I would also like to thank Mr. Bowsher. We would have liked to get information to him sooner, but sometimes that just wasn't possible.

Mr. Chairman, just as the OMB and CBO numbers paralleled each other very closely this time, I think that the statements of Dr. Miller and mine parallel each other very closely. I don't think I will take your time repeating what he said. There are a few points about ambiguities and possible aberrations in the law, however, which were not discussed and which I raise at the end of my statement.

But having made that point, why don't I just take your questions on the whole statement?

Chairman DOMENICI. Thank you, I really appreciate that.

[The prepared statement of Dr. Penner follows:]

PREPARED STATEMENT OF DR. RUDOLPH G. PENNER, DIRECTOR, CONGRESSIONAL BUDGET OFFICE

Mr. Chairman, I am pleased to have the opportunity to testify on our experience in implementing the provisions of the Balanced Budget and Emergency Deficit Control Act of 1985 (P.L. 99-177)--or, more briefly, the Balanced Budget Act. My statement this afternoon will cover three areas:

- The highlights of the joint CBO/OMB sequestration report to the Comptroller General;
- A description of the process by which the joint report was prepared; and
- A discussion of some conceptual issues and technical problems we encountered in our work.

JOINT CBO/OMB SEQUESTRATION REPORT

The Balanced Budget Act establishes an automatic spending reduction procedure if the federal deficit is estimated by OMB, CBO and GAO to exceed certain specified amounts. The maximum deficit amounts decrease each year from $171.9 billion for fiscal year 1986 to zero for 1991. Any necessary spending reductions are to be accomplished through the sequestration of budgetary resources. Except for trust and special funds, this involves permanently cancelling new budget authority and other spending authority to obligate and expend funds. For 1986, the outlay reduction is limited by the Act to a maximum of $11.7 billion, regardless of the amount of the excess deficit. In later years, the amount of possible outlay reductions is not limited.

The first step in the sequestration process is a joint report by the Directors of CBO and OMB to the Comptroller General that estimates budget base levels and calculates the amounts of budgetary resources to be sequestered. Our report for 1986 was delivered on January 15, as required by the Act. It was also published in the Federal Register on that date.

The CBO/OMB report covers 418 pages, most of which are budget account listings. There is a 20-page summary at the beginning of the report that we have also printed separately and distributed to Members of the Committee. This summary provides a good description of our sequestration calculations, and I would like to go through a number of its tables quickly to highlight the major features.

Base Level Budget Estimates

Table 1 of our report summary shows the CBO and OMB base level estimates for 1986. Our deficit estimates are remarkably close--within $800 million of each other. The average of the two deficit estimates is $220.5 billion, which exceeds the $171.9 billion maximum deficit amount by $48.6 billion. This is far more than enough to invoke the full amount of the $11.7 billion spending reduction established by the Balanced Budget Act.

TABLE 1. BUDGET BASE LEVELS FOR 1986
(In billions of dollars)

Budget Aggregates	OMB Estimates	CBO Estimates	Average
Revenues	774.9	777.2	776.0
Outlays	994.9	998.0	996.5
Deficit	220.1	220.9	220.5

SOURCES: Congressional Budget Office and Office of Management and Budget.

The CBO base level deficit estimate is $220.9 billion, which is $26.2 billion higher than the $194.6 billion deficit estimate we made last November for the conference committee on H.J. Res. 372. The November estimate was based on our August economic forecast, tax and spending laws in effect at that time, and 1985 appropriation levels. Our latest deficit estimate is based on a new economic forecast, tax and spending laws as of January 10, 1986, and 1986 appropriation levels.

Approximately $10 billion of the higher CBO deficit estimate can be attributed to changes in our economic forecast for 1986. These changes result in somewhat lower revenues and a very slight change in net interest costs. The remaining $16 billion increase can be attributed to Congressional legislative actions and to technical reestimates of spending. The largest change in outlay estimates is for agriculture programs, primarily CCC farm price support programs (+$10.0 billion). The farm bill passed in December added $2 billion to $3 billion to estimated 1986 outlays, and lower farm commodity prices have led to a sharp upward revision in our spending estimates by $7 billion to $8 billion. The other major change in our outlay estimates is for national defense programs (+$7.7 billion). The 1986 appropriation level is somewhat higher than for 1985, which adds roughly $4 billion in outlays. The rest is a technical reestimate based on the faster spending rates for defense programs that have occurred since July.

Economic Assumptions

Table 2 of the report shows the latest CBO and OMB economic assumptions for fiscal year 1986. As would be expected from the closeness of our budget estimates, our economic assumptions for the major variables are quite similar.

TABLE 2. ECONOMIC ASSUMPTIONS (Fiscal Year 1986)

Economic Variable	OMB	CBO
Gross National Product:		
Current dollars (in billions of dollars)	4,209	4,192
Percent change, year over year	6.9	6.5
Constant (1982) dollars (in billions of dollars)	3,675	3,658
Percent change, year over year	3.5	3.0
GNP Implicit Price Deflator (percent change, year over year)	3.3	3.4
CPI-W (percent change, year over year)	3.3	3.3
Civilian Unemployment Rate (percent, fiscal year average)	6.9	6.9
Interest Rates (fiscal year average)		
91-day Treasury bills	7.3	6.9
10-year Treasury notes	9.2	9.2

SOURCES: Congressional Budget Office and Office of Management and Budget.

The Balanced Budget Act requires CBO and OMB to include in our joint report real economic growth rates for each quarter of the relevant fiscal year, and the last two quarters of the preceding fiscal year. Our projections for fiscal year 1986 and the last two quarters of fiscal year 1985 are provided in Table 3 of the report. If either CBO or OMB project real economic growth to be less than zero for any two consecutive quarters, or if the Department of Commerce reports actual real growth to be less than 1 percent for two consecutive quarters, many of the provisions of the Act could be suspended by the Congress, including a sequestration order if it has not already gone into effect. As you can see in Table 3, however, both CBO and OMB are projecting real growth in the 3 percent to 4 percent range, and actual growth for the last two quarters as reported by the Department of Commerce has been above 1 percent.

TABLE 3. REAL ECONOMIC GROWTH RATES BY QUARTER
(In percents, annual rates)

	FY 1985 Actual [a]		FY 1986 Estimates			
	Apr-Jun 1985	Jul-Sep 1985	Oct-Dec 1985	Jan-Mar 1986	Apr-Jun 1986	Jul-Sep 1986
OMB	1.1	3.0	4.2	4.0	4.0	4.0
CBO	1.1	3.0	3.2 [a]	3.5	3.3	3.4

SOURCES: Congressional Budget Office and Office of Management and Budget.

a. As reported by the Department of Commerce (December 20, 1985).

Sequesterable Resources

Table 4 of the report summary provides further detail on the CBO and OMB base level outlay estimates for 1986. This table shows that a relatively small portion of 1986 outlays will be affected by the sequestration of budgetary resources. About $110 billion of estimated 1986 outlays for defense programs, or 40 percent of total defense spending, are associated with budgetary resources subject to an across-the-board percentage reduction. The special 1986 exemption for military personnel accounts made by the President removed more than $60 billion in outlays from the sequesterable portion.

About $240 billion, or one-third of estimated outlays for nondefense programs, is associated with sequesterable budgetary resources. Nearly $50 billion are for programs with automatic spending increases, primarily military and federal civilian employee retirement and disability programs. For these programs, the amount of spending reduction required by the Act is limited to the cost-of-living adjustments, which were generally 3.1 percent for 1986.

Another $87 billion in nondefense outlays are associated with certain special rule programs, of which the largest is Medicare. The Act also limits the extent of spending reductions for these programs; for example, 1 percent for Medicare in 1986 and not more than 2 percent in future years. Only slightly more than $100 billion in 1986 nondefense outlays--about

TABLE 4. BASE LEVEL OUTLAY ESTIMATES FOR 1986
(In billions of dollars)

Category	OMB Estimates	CBO Estimates	Average
Defense Programs a/			
Subject to across-the-board reduction	106.2	112.4	109.3
Other b/	164.7	162.1	163.4
Subtotal, defense programs	270.9	274.6	272.8
Nondefense Programs			
Programs with automatic spending increases c/	48.9	48.4	48.6
Certain special rule programs d/	87.0	87.1	87.1
Subject to across-the-board reduction	104.3	106.1	105.2
Major exempt programs			
Social security and railroad retirement tier 1	202.6	202.0	202.3
Net interest	137.9	136.9	137.4
Earned income tax credit	1.3	1.3	1.3
Low-income programs e/	60.9	61.1	61.0
Veterans compensation and pensions	14.3	14.3	14.3
State unemployment benefits	18.2	18.1	18.2
Offsetting receipts	-50.2	-50.5	-50.4
Other f/	98.8	98.7	98.8
Subtotal, nondefense programs	724.0	723.4	723.7
Total	994.9	998.0	996.5

SOURCES: Congressional Budget Office and Office of Management and Budget.

a. Budget function 050 excluding FEMA programs.

b. Outlays from obligated balances and the portion of military personnel accounts exempted by the President for 1986.

c. Primarily federal employee retirement and disability programs.

d. Guaranteed student loans, foster care and adoption assistance, medicare, veterans medical care, community health, migrant health, and Indian health.

e. AFDC, child nutrition, medicaid, food stamps, SSI, and WIC.

f. Outlays from prior-year appropriations, certain prior legal obligations, and small exempt programs.

15 percent--are associated with budgetary resources subject to an across-the-board percentage reduction. Over $380 billion--or more than one-half of total estimated outlays for nondefense programs--are entirely exempt from sequestration by the Act. As shown by Table 4, these exempt outlays are mostly Social Security benefits and net interest costs.

Sequestration Calculations

Table 5 of the report summary provides the major elements of our sequestration calculations. Although the sequestration actually applies to new budget authority and other spending authority, the calculations use outlay estimates to determine the amount of sequestration.

The first step is to divide the amount of required deficit reduction--$11.7 billion for 1986--into two halves. One-half--$5,850 million--is assigned to defense programs (budget accounts in function 050) and the other half to nondefense programs.

Second, the total amount of outlay savings from eliminating automatic spending increases is calculated. One-half of the resulting savings for indexed retirement and disability programs are applied to the required reduction in defense programs and one-half to nondefense programs. This amounts to an estimated $994 million for 1986, so that $497 million is subtracted from the $5,850 million required reduction for both defense and nondefense programs.

TABLE 5. SEQUESTRATION CALCULATIONS FOR 1986
(Outlays in millions of dollars)

Category	OMB	CBO	Average
Defense Programs:			
Total required reductions	5,850	5,850	5,850
Estimated savings from automatic spending increases:			
Indexed retirement programs a/	496	497	497
Amount remaining to be obtained from uniform percentage reductions of budget resources	5,354	5,353	5,353
Estimated outlays associated with sequesterable budget resources	106,225	112,446	109,335
Uniform reduction percentage	5.0	4.8	4.9
Nondefense Programs:			
Total required reductions	5,850	5,850	5,850
Estimated savings from automatic spending increases:			
Indexed retirement programs	496	497	497
Other indexed programs	45	45	45
Estimated savings from the application of special rules:			
Guaranteed student loans	10	10	10
Foster care and adoption assistance	5	5	5
Medicare	300	300	300
Other health programs	82	83	82
Amount remaining to be obtained from uniform percentage reductions of budget resources	4,912	4,911	4,912
Estimated outlays associated with sequesterable budget resources b/	114,444	115,080	114,762
Uniform reduction percentage	4.3	4.3	4.3

SOURCES: Congressional Budget Office and Office of Management and Budget.

a. These retirement programs are not included in the national defense function of the budget; most are included in the income security function.

b. Includes estimated 1987 outlays for the Commodity Credit Corporation (CCC) that can be affected by a 1986 sequester (see discussion of special rule for the CCC). The OMB estimate is $10,095 million, the CBO estimate is $8,940 million, and the average is $9,518 million.

Various additional calculations are made for nondefense programs. These include the savings that can be obtained by eliminating automatic spending increases in three other specific programs--the National Wool Act, the special milk program, and vocational rehabilitation grants. Also included are savings that are to be obtained by applying special rules for guaranteed student loans, foster care and adoption assistance, Medicare, and certain health programs. These estimated savings amount to another $442 million, which is also subtracted from the $5,850 million required reduction in nondefense outlays.

This leaves $5,353 million for defense programs and $4,912 million for nondefense programs to be obtained by an across-the-board uniform percentage reduction in budgetary resources. The uniform percentages are calculated by dividing these dollar amounts by total estimated 1986 outlays associated with sequesterable budgetary resources. For defense programs, the sequesterable outlay base is $109.3 billion. For nondefense programs, the base is $114.8 billion, which includes $9.5 billion of 1987 outlays for farm price support programs that can be affected by the 1986 sequestration. The resulting percentages are 4.9 percent for defense programs, and 4.3 percent for nondefense programs. These percentages are then applied to the new budget authority and other spending authority in the sequester base.

Had the President not exempted the bulk of the military personnel accounts from sequestration, the uniform percentage reduction for defense programs would have been 3.1 percent. Similarly, had the Balanced Budget Act not limited the maximum 1986 deficit reduction to $11.7 billion, so that the full $48.6 billion excess deficit would have to be removed, the uniform reduction percentages would have been 21.8 percent for defense programs (assuming the exemption of the military personnel accounts) and 20.3 percent for nondefense programs.

The required reductions in spending authority of various types are summarized in Tables 7, 8, and 9 in the report. The required reductions in more than 800 separate budget accounts, and in 4,000 defense programs, projects, and activities are itemized in the Federal Register. For defense programs in function 050, the required reduction in spending authority (new budget authority and unobligated balances) amounts to $13.8 billion to achieve outlay savings of $5.4 billion. This defense outlay reduction is lower than one-half of the $11.7 billion required reduction because the savings from eliminating automatic spending increases for federal retirement programs--including military retirement--are counted in the income security function and are shown in the nondefense savings table.

For nondefense programs, the required reduction in spending authority is $10.5 billion, $1.6 billion in direct loan obligations, and $7.3 million in new loan guarantee commitments. These reductions are estimated to produce $6.3 billion in outlay savings, including $0.4 billion in estimated 1987 outlay savings for Commodity Credit Corporation (CCC) programs. In most

TABLE 7. DEFENSE PROGRAM SEQUESTRATIONS FOR 1986
(In billions of dollars)

Function 050	Spending Authority a/	Estimated Outlays
Department of Defense-Military:		
Military personnel	0.2	0.2
Operation and maintenance	3.9	2.9
Procurement	6.6	0.9
Research, development, test, and evaluation	1.9	0.9
Military construction	0.5	0.1
Family housing and other	0.2	0.1
Subtotal, DoD	13.3	5.1
Atomic energy defense activities	0.4	0.2
Other defense-related activities b/	0.1	c/
Total	13.8	5.4

SOURCES: Congressional Budget Office and Office of Management and Budget.

a. Includes new budget authority for 1986 and unobligated balances from budget authority provided in previous years.

b. Includes the function 050 portion of Federal Emergency Management Agency budget accounts which are reduced at the same rate as nondefense programs.

c. Less than $50 million.

TABLE 8. NONDEFENSE PROGRAM SEQUESTRATIONS FOR 1986
(In billions of dollars)

Function	Spending Authority a/	Direct Loan Obligations	Loan Guarantees	Estimated Outlays
International affairs	0.9	0.3	0.5	0.5
General science, space and technology	0.4	---	---	0.3
Energy	0.3	0.2	0.1	0.1
Natural resources and environment	0.6	b/	---	0.4
Agriculture	0.9	0.7	0.3	1.0 c/
Commerce and housing credit	0.2	0.2	5.7	0.2
Transportation	1.9	b/	b/	0.4
Community and regional development	0.2	0.1	b/	0.1
Education, training, employment, and social services	1.2	b/	---	0.4
Health	0.5	b/	---	0.3
Medicare	0.4	---	---	0.4
Income security	1.8	b/	---	1.3
Social security	0.1	---	---	0.1
Veterans benefits and services	0.2	b/	0.5	0.2
Administration of justice	0.3	---	---	0.3
General government	0.3	---	---	0.3
General purpose fiscal assistance	0.3	---	---	0.2
Total	10.5	1.6	7.3	6.3

SOURCES: Congressional Budget Office and Office of Management and Budget.

a. Includes new budget authority, obligation limitations, and other spending authority for 1986.

b. Less than $50 million.

c. Includes $0.4 billion in estimated 1987 outlay savings for Commodity Credit Corporation (CCC) programs (see discussion of special rule for CCC).

TABLE 9. SEQUESTRATIONS FOR 1986 BY AGENCY
(In billions of dollars)

Department or Other Unit	Spending Authority a/	Direct Loan Obligations	Loan Guarantees	Estimated Outlays
Legislative Branch	0.1	---	---	0.1
The Judiciary	b/	---	---	b/
Executive Office of the President	b/	---	---	b/
Funds appropriated to the President	0.6	0.3	b/	0.3
Agriculture	1.3	1.1	0.5	1.3 c/
Commerce	0.1	b/	b/	0.1
Defense-Military	13.3	---	---	5.1
Defense-Civil	0.6	---	---	0.5
Education	0.7	b/	---	0.2
Energy	0.6	---	---	0.3
Health and Human Services	1.3	b/	---	1.0
Housing and Urban Development	0.7	b/	5.5	b/
Interior	0.3	b/	b/	0.2
Justice	0.2	---	---	0.1
Labor	0.4	---	---	0.2
State	0.1	b/	---	0.1
Transportation	1.8	b/	b/	0.4
Treasury	0.4	---	---	0.4
Environmental Protection Agency	0.1	b/	---	b/
General Services Administration	0.1	---	---	b/
National Aeronautics and Space Administration	0.3	---	---	0.2
Office of Personnel Management	0.6	---	---	0.6
Small Business Administration	b/	0.1	0.2	b/
Veterans Administration	0.2	b/	0.5	0.2
Other independent agencies	0.4	0.1	0.5	0.3
Total	24.3	1.6	7.3	11.7

SOURCES: Congressional Budget Office and Office of Management and Budget.

a. Includes new budget authority for 1986, unobligated balances from budget authority provided in previous years (Defense-Military and other function 050 programs and certain administrative costs), obligation limitations for and other spending authority for 1986.

b. Less than $50 million.

c. Includes $0.4 billion in estimated 1987 outlay savings for Commodity Credit Corporation (CCC) programs (see discussion of special rule for CCC).

instances, additional outlay savings will be gained in 1987 and later fiscal years as the result of eliminating the 1986 cost-of-living adjustments and cancelling 1986 budget authority. We did not calculate these outlay savings for our report to the Comptroller General, but a rough CBO estimate for the 1987 savings is $7 billion to $8 billion.

CBO/OMB WORK EFFORT

The joint CBO/OMB work on the report went very smoothly. A tremendous amount of work was accomplished in a very short time period with no major disruptions as a result of an excellent cooperative working relationship. I join OMB Director Miller in expressing my appreciation for the outstanding professional job done by both agency staffs. I also want to thank the Assistant Secretary for Comptroller of the Defense Department and his staff for the cooperation they gave us and the work that they did in preparing the defense program, project, and activity detail for the CBO/OMB sequestration report.

We started meeting with OMB staff before Christmas to discuss a few conceptual issues that arose in applying the Balanced Budget Act to certain budget accounts. Most of the provisions of the new Act were sufficiently clear for us to implement, but we did have some relatively minor problems. Although the Act directs us to average our differences where we could not reach agreement on various budget estimates, this clearly made no sense for conceptual differences. Accordingly, we worked diligently to eliminate any differences that derived from different interpretations of how to apply the various provisions of the Act. We concluded that it was less important to eliminate any differences that resulted from different technical estimates because, in these cases, averaging made sense. An average of two different technical estimates in most instances would be as good as either of the two agency estimates.

Each agency prepared its own estimates of sequesterable budgetary resources for 1986 and associated outlays. We then combined these two sets of estimates on the OMB computer system and examined the differences. After considerable discussion between the two agency staffs, we were able to narrow our differences to the point where an average would produce an acceptable result.

To assist the General Accounting Office (GAO) in fulfilling their responsibilities under the Act, we shared our calculations with them several days in advance of the January 15 reporting date. After January 15, we brought to GAO's attention several items that we discovered we had treated in an inconsistent manner or had overlooked. Throughout the period, we have also had a good cooperative working relationship with GAO.

SOME CONCEPTUAL ISSUES

By the report date, only one conceptual issue was left unresolved by CBO/OMB staff. There was, however, another issue where a large number of budget accounts were involved, and which, therefore, had to be resolved before we completed the report. CBO sought a preliminary ruling from the General Accounting Office before agreeing to OMB's proposed solution. This case concerned programs and activities that are fully or partially financed by user fees or other offsetting collections from nonfederal sources that are credited to budget accounts.

Offsetting Collections from Nonfederal Sources

The issue was whether the sequestration should be applied to the gross level of program activity, regardless of the source of financing, or only to that portion financed by annual appropriations. An example of a program partially financed by offsetting collections is the Patent and Trademark Office, which in 1985 had total spending of $200 million and offsetting collections from the public of $107 million.

We were advised that GAO agreed with OMB that all activities financed by offsetting collections from nonfederal sources would be sequesterable under the revised definition of spending authority in the Congressional Budget Act of 1974 contained in section 401(c)(2). This definition covers so-called backdoor spending authority that is not subject to the annual review of the appropriations process, such as certain permanent appropriations. The Balanced Budget Act requires the sequestration of this type of spending authority for nondefense programs, but not for defense programs. Thus, the sequestration was applied to the gross level of program activity.

WMATA Interest Payments

The other conceptual issue that the staffs were not able to resolve concerned a $51.7 million appropriation for interest payments to be made to the Washington Metropolitan Area Transit Authority (WMATA). As authorized by law, the Secretary of Transportation agreed several years ago to pay two-thirds of the principal and interest due on $997 million in borrowing by WMATA. Although these payments were not explicitly exempted by the Act, CBO regarded them as nonsequesterable because of a previous federal guarantee of the WMATA bonds by the Secretary of Transportation. OMB agreed that the appropriation ought not to be sequestered, but did not believe this outcome was permitted by the Balanced Budget Act. This issue was left to the Comptroller General to resolve. In the meantime, we averaged the results of the two different positions, even though the result is not consistent with either of our views. The Comptroller General in his report yesterday agreed with CBO that the WMATA interest payment for 1986 is not sequesterable.

Administrative Expenses

One of the more difficult areas in which to apply the Act was administrative expenses for programs otherwise exempt or covered by a special rule. The Act clearly requires sequestering the administrative expenses of all federal programs (unless these expenses were specifically exempted), including those that are self-supporting. In many cases, these administrative expenses were clearly identified in budget accounts, either by the title of the account, an appropriation limitation, or by expenses covered by object classes--11 (personnel compensation) through 26 (supplies and materials). In a few instances, however, this approach would have had the effect of negating the exemption or special rule, such as for the Postal Service, veterans' medical care, several power marketing administrations, and the Tennessee Valley Authority. In these cases, the estimate of administrative expenses was developed jointly with OMB and was intended to reflect only what could be called overhead expenses.

We had also included as sequesterable certain nondefense administrative expenses that are financed by unobligated balances. We believed the section in the Balanced Budget Act had the effect of overriding other provisions, but I understand that the Comptroller General has concluded otherwise. This is a good illustration of one area of the Act that is not entirely clear and could be changed in any technical corrections bill.

Reappropriations

An example of a conceptual issue that was resolved by the CBO and OMB staffs concerned the scoring of reappropriations. These involved actions of the Congress to continue the availability of obligational authority that has or would have otherwise expired. CBO scores reappropriations as budget authority in the year for which the availability is extended. OMB scores appropriations as budget authority in the fiscal year in which the reappropriation action is included, regardless of when the authority would otherwise expire. A number of reappropriations for nondefense programs were included in the 1985 Supplemental Appropriation Act. CBO scored these as new budget authority for 1986, which is sequesterable. OMB and the agencies, however, scored these as 1985 authority and treat these as unobligated balances in 1986, which are not sequesterable for nondefense programs. Applying the CBO scoring method would have required a change of OMB and agency accounting practices, which could not be done in the time available. Therefore, CBO agreed with the OMB approach for the purposes of implementing the Balanced Budget Act, although we will continue to use our convention for scoring appropriation bills against Congressional budget resolutions.

Names and Numbers

A problem that we encountered in interpreting the Act concerned the use of program names and budget account numbers in the sections that exempted certain items from sequestration or defined automatic spending increase programs. Essentially, we had a problem answering two questions. First, when the numbered budget account contains activities in addition to the named program, do those activities also qualify for special treatment? Second, in the case of indexed programs, are nonindexed activities included in a referenced budget account protected from sequestration by virtue of section 255(f)?

After some deliberation, we concluded that the answer generally was "no" to both questions, that the program names and budget accounts were meant to serve as pointers or clues as to which programs were to be given special treatment and did not involve any significance beyond this. It would have been better, of course, for the Act to include specific statutory citations to the affected programs, but there probably was not enough time to do this in the drafting of H.J. Res. 372.

Some Anomalies

As we prepared our sequestration calculations, some anomalies appeared that the Congress may wish to consider for a technical corrections bill in addition to the issues and problems I have already described. One anomaly concerns the operations of the Panama Canal Commission. The Commission collects tolls from ships using the Canal, which are deposited in the Treasury and scored as offsetting receipts in function 400 (transportation programs). To operate the Canal, the Commission receives an annual appropriation, based on an estimate of incoming receipts. According to the Panama Canal Treaty, any excess of revenues over expenditures is to be paid to Panama. Thus, the sequestration of operating funds will have the effect of enriching Panama and will not help reduce the federal deficit.

Another anomaly concerns unemployment benefits for railroad workers. The Balanced Budget Act specifically exempts regular state unemployment benefits, the state share of extended unemployment benefits, and benefits paid to former federal employees and former members of the armed services. At the same time, it is silent with respect to railroad worker unemployment benefits. These benefits, therefore, were presumed to be sequesterable, which is probably an unintended result. Unfortunately, we found no statutory justification for not appying the uniform reduction percentage to these benefits.

Although unobligated balances in defense programs are sequesterable, they are not sequesterable in nondefense programs. I discussed earlier how we were unable to apply CBO's scoring convention for reappropriations to nondefense programs, which had the effect of reducing the amount of sequesterable spending authority for 1986, at least from CBO's scoring base. Other possible new spending authority that escaped sequestration involves the transfer of unobligated balances in nondefense budget accounts to other accounts for the purpose of financing new or different programs. An example of this is the transfer in 1986 of $400 million of unobligated balances from the Synfuels Corporation to the Department of Energy for the purpose of funding a new clean coal technology program. Since this transfer does not involve new budget authority in 1986, it could not be sequestered.

Another anomaly arises from the definition of a budget account in the Act. For items not provided in appropriation bills, an account is to be found by looking in the Appendix to the President's budget. By tradition, however, certain Legislative Branch accounts do not appear in the Appendix, such as compensation of Members of the House and the Senate and several revolving funds for restaurants, barber shops, and other activities. Consequently, these accounts escaped sequestration. This result may have been intended, at least for Member compensation, given the Act's prohibition against reducing rates of pay for federal employees under a sequester order.

Federal Reserve System

One of the changes made by the Balanced Budget Act was to bring on budget certain federal entities that formerly were off-budget, such as the Federal Financing Bank, the Postal Service fund, and strategic petroleum reserve purchases. We considered whether this change also affected the Federal Reserve System, at least the Board of Governors. We concluded that it did not, as Director Miller has testified, largely because there was no legislative history to support its inclusion.

CONCLUSION

The issues and problems I have described are relatively minor when viewed in the context of administering a law as complex as the Balanced Budget and Emergency Deficit Control Act of 1985. This is not to say that we had an easy time in preparing our joint sequestration report. Rather, the Act was sufficiently clear in most instances to allow us to work out the details of the report with a minimum of difficulty. Objections about the results of our calculations are more likely to involve specific provisions of the Act than our application of these provisions to various budget accounts.

Chairman DOMENICI. Mr. Bowsher.

STATEMENT OF HON. CHARLES A. BOWSHER, COMPTROLLER GENERAL OF THE UNITED STATES

Mr. BOWSHER. Mr Chairman, I think I can summarize ours very quickly. As you're aware, we received a joint report from OMB and CBO. I might again thank them for their cooperation in getting material to us even before the official report. We then reviewed those accounts in the joint report. We came up with one significant change in the defense area involving $6.3 billion of transfer authority which had not been moved out of the appropriations or the procurement accounts that they were in. We decided that that amount was subject to sequester like every other account, and we made that adjustment.

We looked very carefully at the spending rates of the different appropriations at the Defense Department. There was a difference in the O&M appropriations between CBO and OMB. We decided that we would accept the average, because we thought that both approaches appeared reasonable and we didn't have any data on spending rates that would have been better.

The changes we made on the civilian side netted out to only about $3 million, and they're detailed in our report. So, on balance, we verified pretty much what the other two organizations had done, and we did not change the 4.9- and the 4.3-percent reductions.

We, too, have a few changes to suggest which are at the end of our statement.

We'd be happy to answer any questions.

Chairman DOMENICI. We'll make your statement a part of the record.

[The prepared statement of Mr. Bowsher follows:]

UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

TESTIMONY OF
CHARLES A. BOWSHER
COMPTROLLER GENERAL OF THE UNITED STATES
BEFORE THE
COMMITTEE ON THE BUDGET
UNITED STATES SENATE
ON
IMPLEMENTATION
OF THE
BALANCED BUDGET AND EMERGENCY
DEFICIT CONTROL ACT OF 1985

Mr Chairman and Members of the Committee:

I am pleased to appear before the Committee to discuss our experience this year in the first implementation of the Balanced Budget and Emergency Deficit Control Act of 1985.

I am accompanied this afternoon by Mr. Harry Havens, Assistant Comptroller General, Mr. James Hinchman, Deputy General Counsel of GAO, and Dr. Lawrence Thompson, Chief Economist of GAO.

We issued our report on January 21, as required by the Act, since January 20 was a legal holiday. I would like to offer a copy of the report for the record. Copies have been provided to you, Mr. Chairman, and to the other members of the Committee.

We changed a number of accounts, 18 for defense programs and 38 for non-defense. However, these changes were not sufficient in the aggregate to alter the general percentage reductions of 4.9 percent for defense and 4.3 percent for non-defense programs, as contained in the report we received from OMB and CBO.

The principal change in defense programs was to add to the sequester base about $6.3 billion of unobligated balances available for transfer. The effect of this addition is to increase the ammount of the sequester by $309 million, with associated outlays of $45 million.

In non-defense programs, there were a variety of changes in both directions. Unlike defense programs, there is no way to represent the change in the sequester base or in the amount of the sequester by single figures because various sorts of budgetary resources were affected and they cannot be added. However, the change in the outlays associated with the sequester is quite small--a net increase of about $3 million--and that is indicative of the size of the changes we made.

Attached to my statement is a listing of the accounts where we made changes, showing the amount of each change. Each of these changes is explained in Appendix A of our report, in a narrative accompanying the table which shows the change being made. We would be happy to discuss any of them about which you or the other Members of the Committee may have question.

The first year implementation of the Act has been accomplished successfully to this point.

As with any first time effort of this sort, a few complications arose which it was necessary to resolve. The significant ones which came to our attention are listed in an attachment. We would be happy to discuss any of those which you would like to pursue.

We would like to point out, however, that this year's process is not yet complete. The President has not yet issued his order, and the operating departments and agencies have not yet fully implemented the required reductions. Thus, additional complications may arise before the process is complete. As we become aware of them, such as in our required review of compliance with the Act, for which our report is to be issued on April 1, we will be bringing them to your attention.

In conclusion, I would like to thank OMB and CBO for the cooperation we received.

That completes my prepared statement, Mr. Chairman. My colleagues and I will be pleased to respond to any questions which you or other Members of the Committee may have.

ATTACHMENT 1

Summary of GAO Changes

(in millions of dollars)

Part I - Defense Program Accounts	GAO Changes In			
	Sequester Base	Associated Outlays	Sequester	Associated Outlays
Aircraft Procurement, Navy	551.3	49.1	27.0	2.4
Weapons Procurement, Navy	15.0	1.6	0.7	0.1
Shipbuilding and Conversion Navy	1,999.3	124.6	98.0	6.1
Other Procurement, Navy	276.5	29.7	13.5	1.5
Aircraft Procurement, Army	117.9	17.7	5.8	0.9
Missile Procurement, Army	66.5	4.8	3.3	0.2
Other Procurement, Army	257.5	20.6	12.6	1.0
Procurement of Weapons and Tracked Combat Vehicles, Army	590.3	26.4	28.9	1.3
Procurement of Ammunition, Army	178.1	48.1	8.7	2.4
Procurement, Marine Corps	47.7	4.6	2.3	0.2
Aircraft Procurement, Air Force	1,110.4	76.2	54.4	3.7
Missile Procurement, Air Force	82.8	19.7	4.1	1.0
Other Procurement, Air Force	347.5	165.7	17.0	8.1
Procurement, Defense Agencies	36.0	9.2	1.8	0.5
RDT&E, Defense Agencies	82.0	37.9	4.0	1.9
RDT&E, Navy	188.0	96.3	9.2	4.7
RDT&E, Army	96.1	49.3	4.7	2.4
RDT&E, Air Force	264.0	128.0	12.9	6.3
Total, Part I	**6,306.9**	**909.5**	**309.0**	**44.6**

ATTACHMENT 1

Summary of GAO Changes (continued)

(in millions of dollars)

Part II - Non-Defense Program Accounts	GAO Changes In			
	Sequester Base	Associated Outlays	Sequester	Associated Outlays
Funds Appropriated to the President				
Agency for International Development				
Housing and Other Credit Guaranty Programs				
Unobligated Balances - Admin.	-6.0	-4.5	-0.3	-0.2
Overseas Private Investment Corporation				
Overseas Private Investment Corp.				
Unobligated Balances - Admin.	-12.4	-11.8	-0.5	-0.5
Department of Agriculture				
Farmers Home Administration				
Agricultural Credit Insurance Fund				
Obligation Limitation	75.8	75.8	3.3	3.3
Rural Housing Insurance Fund				
Obligation Limitation	56.0	56.0	2.4	2.4
Department of Commerce				
General Administration				
Salaries and Expenses				
Unobligated Balances - Admin.	-4.6	-4.6	-0.2	-0.2

ATTACHMENT 1

Summary of GAO Changes (continued)

(in millions of dollars)

Part II - Non-Defense Program Accounts	GAO Changes In			
	Sequester Base	Associated Outlays	Sequester	Associated Outlays
Department of Commerce				
National Oceanic and Atmospheric Administration				
Federal Ship Financing Fund, Fishing Vessels				
Unobligated Balances - Admin.	-1.3	-1.3	-0.1	-0.1
Fishing Vessel and Gear Damage Compensation Fund				
Unobligated Balances - Admin.	-0.2	-0.2	*	*
Fishermen's Contingency Fund				
Unobligated Balances - Admin.	-0.1	-0.1	*	*
National Bureau of Standards				
Working Capital Fund				
Budget Authority	2.1	1.6	0.1	0.5
Department of Defense - Civil				
Corps of Engineers - Civil				
General Expenses				
Unobligated Balances - Admin.	-3.4	-3.4	-0.1	-0.1

Summary of GAO Changes (continued)

(in millions of dollars)

Part II - Non-Defense Program Accounts	GAO Changes In			
	Sequester Base	Associated Outlays	Sequester	Associated Outlays
Department of Education				
Office of Postsecondary Education				
College Housing Loans				
Unobligated Balances - Admin.	-4.1	-1.2	-0.2	-0.1
Department of Energy				
Energy Production				
Alternative Fuels Production				
Unobligated Balances - Admin.	-0.2	-0.2	*	*
Power Marketing Administration				
Operation and Maintenance, Southeastern Power Administration				
Unobligated Balances - Admin.	-1.0	-0.9	*	*
Department of Health and Human Services				
Alcohol, Drug Abuse, and Mental Health Administration				
Federal Subsidy for St. Elizabeth's Hospital				
401(C) Authority - Off. Collections	-25.0	-25.0	-1.1	-1.1

Summary of GAO Changes (continued)

(in millions of dollars)

Part II - Non-Defense Program Accounts	GAO Changes In			
	Sequester Base	Associated Outlays	Sequester	Associated Outlays
Department of Health and Human Services				
Social Security Administration				
Child Support Enforcement				
Unobligated Balances - Admin.	-1.2	-1.2	-0.1	-0.1
Federal Old Age and Survivors Insurance Trust Fund				
Unobligated Balances - Admin.	-121.3	-40.0	-5.2	-1.7
Department of Housing and Urban Development				
Government National Mortgage Association				
Management and Liquidating Functions Fund				
Unobligated Balances - Admin.	-1.0	-1.0	*	*
Rehabilitation Loan Fund				
Unobligated Balances - Admin.	-19.7	-19.7	-0.8	-0.8
Department of Justice				
Office of Justice Programs				
Justice Assistance				
Unobligated Balances - Admin.	-3.4	-0.4	-0.1	-0.1

ATTACHMENT 1

Summary of GAO Changes (continued)

(in millions of dollars)

Part II - Non-Defense Program Accounts	GAO Changes In			
	Sequester Base	Associated Outlays	Sequester	Associated Outlays
Department of Treasury				
Financial Management Service				
Energy Security Reserve				
Unobligated Balances - Admin.	-3.0	-3.0	-0.1	-0.1
United States Customs Service				
Miscellaneous Permanent Appropriations				
Budget Authority	105.0		4.5	
Obligation Limitation	-20.4		-0.9	
Outlays		84.6		3.3
Internal Revenue Service				
Internal Revenue Collections for Puerto Rico				
Budget Authority	245.0	245.0	10.5	10.5
Comptroller of the Treasury				
Assessment Funds				
401(C) Authority	23.9		1.0	
401(C) Authority Off.Coll.	9.4		0.4	
Outlays		32.7		1.4
Environmental Protection Agency				
Hazardous Substance Response Trust Fund				
Unobligated Balances - Admin.	-39.5	-33.9	-1.7	-1.5

Summary of GAO Changes (continued)

(in millions of dollars)

Part II - Non-Defense Program Accounts	GAO Changes In			
	Sequester Base	Associated Outlays	Sequester	Associated Outlays
Small Business Administration				
Salaries and Expenses				
Unobligated Balances - Admin.	-90.0	-90.0	-3.9	-3.9
White House Conference on Small Business				
Unobligated Balances - Admin.	-1.0	-1.0	*	*
District of Columbia				
Federal Payment to the District of Columbia				
Budget Authority	-39.6	-39.6	-8.5	-8.5
Transitional Payment for St. Elizabeth's Hospital				
Budget Authority	25.0	25.0	1.1	1.0
Criminal Justice Initiative				
Budget Authority	13.9	13.9	0.6	0.6
Student Dropout Prevention Initiative				
Budget Authority	0.2	0.2	*	*
Job Training Initiative				
Budget Authority	0.5	0.5	*	*

ATTACHMENT 1

Summary of GAO Changes (continued)

(in millions of dollars)

Part II - Non-Defense Program Accounts	GAO Changes In			
	Sequester Base	Associated Outlays	Sequester	Associated Outlays
District of Columbia				
Court Study				
Budget Authority	0.1	0.1	*	*
Federal Deposit Insurance Corporation				
Federal Deposit Insurance Corporation				
401(C) Authority Off. Coll.	8.2	8.2	0.4	0.4
Other Independent Agencies				
Other Historical and Memorial Agencies Christopher Columbus Quincentennary Jubilee Commission				
Unobligated Balances - Admin.	-0.2	-0.2	*	*
Washington Metropolitan Area Transit Authority Interest Payments				
Budget Authority	25.8	25.8	-1.1	-1.1
National Endowment for the Arts Grants and Administration				
Unobligated Balances - Admin.	-0.2	*	*	*

Summary of GAO Changes (continued)

(in millions of dollars)

Part II - Non-Defense Program Accounts	GAO Changes In			
	Sequester Base	Associated Outlays	Sequester	Associated Outlays
Other Independent Agencies				
Railroad Retirement Board				
Milwaukee Railroad Restructuring, Admin.				
Unobligated Balances - Admin.	-0.2	*	*	*
Corporation for Public Broadcasting				
Public Broadcasting Fund				
Budget Authority	159.5	159.5	0	0
Totals, Part II				
Budget Authority	**537.4**		**7.3**	
401(C) Authority	**23.9**		**1.0**	
401 (C) Authority - Off. Coll.	**-7.5**		**-0.3**	
Obligation Limitation	**111.3**		**4.8**	
Unobligated Balances - Admin.	**-312.9**		**-13.4**	
Outlays		**445.5**		**3.3**

* = Amounts less than $50,000

Attachment 2

Matters for Consideration

A. Statutory changes for consideration

We noted 5 instances in which the outcome of applying the rules does not appear to be consistent with the general approach taken with regard to other programs.

1. Washington Metropolitan Area Transit Authority

   The Act requires a reduction in the annual appropriations to meet the Government's obligation to pay part of the debt service on Washington Metropolitan Area Transit Authority bonds. If the Government's failure to make its full payment led to a default on the bonds, the Government would still have to pay because the Federal Government has guaranteed the bonds. We believe it would be reasonable to exempt this program.

2. Federal Annuitant Health Insurance

   The Act does not exempt the appropriation for the Federal share of Federal retirees' health insurance premiums from reduction even though the Act provides for no change in the health insurance program for Federal employees. We believe it would be reasonable to exempt this program.

3. Railroad Unemployment Insurance

   Payment of unemployment insurance compensation by the Railroad Retirement Board from the Federal Unemployment Trust Fund is not exempt from reduction under the Act, even though payments of regular unemployment compensation by States from that fund are exempt. We believe it would be reasonable to treat railroad unemployment the same as regular unemployment compensation.

4. Panama Canal

   Because of prior Treaty obligations, the savings resulting from administrative cost reductions of the Panama Canal Commission accrue to the benefit of the Republic of Panama rather than to the United States Government.

5. Mine Worker Exemption

   Section 256(i) and section 257(1)(A) of the Act are redundant. Both have the effect of limiting reductions in disability benefits under the Federal Mine Safety and Health Act to the reduction or elimination of automatic spending increases.

B. Treatment of Discrepancies between program names and account listings

In at least two accounts exempted by section 255(h), a relatively small amount is appropriated for a program that, though similar in purpose to the exempted program, is not the program named in the Act. These are the adult categorical amounts contained in the Assistance Payments (Aid to Families with Dependent Children) Account (75-0412-0-1-609) and the commodity supplemental food program contained in the Feeding Program for Women, Infants and Children (WIC) Account (12-3510-0-1-605).

C. Definition of Account

Public Law 97-177 defines an account as "an item for which appropriations are made in any appropriation Act." It is not entirely clearly what constitutes an "item" in an appropriation. For example, the District of Columbia appropriation act includes eight specified amounts under six separate headings. It is not clear whether this constitutes one, six, or eight accounts.

D. Administrative expenses funded from unobligated balances

Section 256(b) of the Act requires reduction of administrative expenses even in otherwise exempt accounts. However, prior year unobligated balances of non-defense agencies are not included in the sequesterable base as defined for those agencies. It is, therefore, not entirely clear whether administrative expenses funded from non-defense unobligated balances should be reduced.

E. Offsetting collections

Section 251 of the Act includes within the sequesterable base for non-defense agencies "spending authority." Spending authority is in turn defined, under another provision of the Act, to include authority "to make payments by the United States (including loans, grants, and payments from revolving funds) *** the budget authority for which is not provided in advance by appropriation acts." There is some uncertainty as to whether this language includes offsetting collections credited to an account.

F. OTHER ISSUES

1. Scorekeeping

There is a need to assure the consistent application of conventions concerning the treatment of some of the less common types of budgetary transactions. This involves such things as reappropriations, obligation limitations, and offsetting collections, where inconsistent application of the conventions could produce inconsistent results.

2. Timing of economic assumptions

Economic assumptions were largely irrelevant to this year's sequestration determination because the maximum permissible sequestrations would have occured under most plausible sets of assumptions. In the future years, variations in economic assumptions will produce variations in sequestration results. The current process provides no statutory mechanism for separating those estimating differences attributable to economic assumptions from the other estimating differences or for agreeing in advance to a common set of economic assumptions.

3. Timing of data sharing

OMB and CBO's sharing with GAO of preliminary data, in compatible machine-readable form in most cases, facilitated GAO's process. It will be especially important for this cooperation to continue in the future when GAO will have one day less to make its determinations.

4. "Program" versus "Administrative" Expenses

Some programs were exempt while the administrative expenses were not. For example, the Postal Service fund is exempt, while the administrative expenses of the Postal Service are not; and payments from the Social Security Trust Fund to beneficiaries are exempt while the administrative expenses of the Social Security Administration are not. There was some difficulty in distinguishing between "program" and "administrative" expenses. These difficulties were overcome, but the Congress may wish to review the results and refine the legislation if the results are not what was expected.

5. Outlay estimating

Different agencies use different methodologies and a variety of data bases in estimating outlays and in particular spend-out rates. These produce different estimates. We sometimes found it difficult to distinguish between differences which resulted from different methodologies from those which reflected different program assumptions.

NO SPECIAL STAFF EFFICIENCIES

Chairman DOMENICI. Mr. Bowsher, let me ask you this: Not that I want to beef up your office, because I'm hopeful this is the last time you'll have to do this, because I think Congress ought to do the work and we ought not have a sequestration again.

Nonetheless, this was a different undertaking for you. Do you have any special staff deficiencies that you noted in working with your experts?

Mr. BOWSHER. No; we really did have staff that could do the job. We asked some people from the outside to come in as consultants to check some of our thinking in the defense area and the economic assumptions area. We would probably do that again in August if we repeat this process. We might hire one or two people, but that would be as part of our normal processes. So, in summary, we don't expect to need any additional resources.

Senator HOLLINGS. That's good.

Chairman DOMENICI. Senator Grassley, I recall earlier in the afternoon you wanted to inquire of GAO. They're here now. Are you prepared to go at this time?

Senator GRASSLEY. Yes; I am, and, Mr. Chairman, as you might expect, I'm somewhat interested in the defense budget and particularly because 50 percent of the savings must come from the defense budget.

I want to be sure that we're dealing with solid figures, so I would like to review some figures with you that would address these concerns that I have about the defense budget. Now, it would appear to me, based on data that I have received from the Department of Defense—let me make that very clear, from the Department of Defense—that the following has occurred with the defense budget, and I have five points:

One, that about $5.5 billion of unobligated authority is unaccounted for; two, that there is a growing disparity between what DOD thinks it can spend versus what it can actually obligate; three, that there is so much money available to DOD that they cannot obligate all of the available authority; four, that there is so much money in the defense budget that obligations are made inefficiently just so that the funds will escape sequester; and five, the defense outlay savings of $5.3 billion may not be real savings, but may be paper savings.

Now, I would like to have you allow me to indicate how I arrived at these tentative conclusions. First, the Department of Defense estimated last year that its unobligated balances for fiscal year 1985 would total $51.6 billion. In order to calculate the actual figures, I took the total available authority of $427.1 billion and then subtracted from it the sum of the 12 monthly obligations for the fiscal year 1985, which appear in DOD's FAD Table No. 746.

Now that came out, then, at $358.2 billion, and that leaves $68.9 billion of unused funds, which is $17.3 billion more than originally estimated.

Now, of course, DOD says that it returned $1.8 billion of that to the Treasury, so you have to subtract that, and that leaves $67 billion.

But DOD's records show only $61.5 billion of that $67 billion in unobligated balances. So, the first of three questions, which quite frankly I ought to ask together: How do we account for the missing $5.5 billion, or the difference between the $67 billion that the table shows, and the $61.5 billion that DOD claims?

And can we also say from the data that there is a growing disparity between estimated and actual obligations, and would this indicate an inability of the Department of Defense to spend the money that it has?

UNOBLIGATED BALANCES ON THE RISE

Mr. **Bowsher**. Senator, let me see if I can answer those questions the way you asked them. There's no question that the unobligated balances are on the rise over at Defense. It generally is an indication that they are getting more money than they can spend, or obligate as fast as they would hope. Thus, I think the trend in unobligated balances that you have cited is correct.

There is an additional problem as well. Under the Gramm-Rudman process, there is an incentive to obligate before all contracts have been priced out. There are dangers associated with the early obligation of contracts and this probably needs to be watched as this program unfolds.

But I think that the Congress did nail down the defense managers by limiting their flexibility. The Gramm-Rudman cuts are spread across individual PPA line items which is below the appropriation account level. Thus, most of the accounts are going to have to take the 4.9-percent hit, unless they are offset by a lot of reprogramming actions.

Senator **Grassley**. Now, if you did, I missed it. What about the $5.5 billion?

Mr. **Bowsher**. I can't give you an answer on that right off the bat. We can explore that and come back with an answer.

[The following was subsequently supplied for the record by GAO:]

In response to Senator Grassley's inquiry about the accounting for unobligated balances in the Department of Defense, GAO staff met twice with senior DOD officials and carefully reviewed their principal budget and accounting reports, the FAD tables. The body of this response and the attached table explain the discrepancy between the $67.1 billion in unobligated balances which Senator Grassley calculated from earlier versions of these same FAD documents and the $61.5 in unobligated balances officially reported by the DOD.

Before covering this reconciliation in detail, it is important to note that the DOD has a variety of accounting and budgeting systems. Because definitions and rules may vary between these systems, it is often difficult to obtain consistent financial records for the department as a whole. These inconsistencies explain much of the $5.5 billion discrepancy. The lack of an integrated financial management system for the federal government (including DOD) is a major concern of GAO. The complexity of the current arrangement sometimes makes it difficult for even a skilled auditor to determine the answers to fundamental financial questions. The GAO will continue to work towards reconciling these systems, unscrambling their inconsistencies, and streamlining the process of financial management both in the DOD and in the entire federal government.

In order to facilitate the reconciliation of the missing $5.5 billion, this response briefly repeats the method used by Senator Grassley to arrive at an estimate of $67.1 billion for DOD unobligated balances and then compares this estimate to DOD's calculation of unobligated balances of $61.5 billion. A table summarizing this reconciliation is attached.

In order to arrive at an estimate of DOD's unobligated balances, Senator Grassley first subtracted the sum of all of DOD's monthly obligations for FY 1985 ($358.2 billion) from the total available authority for obligation reported in an early FY 1985 FAD table ($427.1 billion). As a second step he then subtracted the amount of lapsing authority ($1.8 billion) to arrive at an estimated unobligated balance of $67.1 billion.

GAO recalculated DOD's end of fiscal year unobligated balance levels using information presented in FAD table number 738/87. These end of year figures are reconciled to the Joint Financial Statement of the U.S. Treasury and are subject to verification by the Office of Management and Budget.

Additionally, GAO staff met with DOD officially to verify the accuracy of its recalculations and achieve an understanding of the disparity among the financial management systems which influence the reporting of this information. The amounts discussed below were taken from DOD summary records without verification by GAO.

Total Availability Authority (TAA) for Obligation during a fiscal year is comprised of (1) unobligated balances brought forward, (2) new budget authority, (3) recoveries from prior obligations, and (4) reimbursable orders. DOD reports year end TAA of $425.4 billion, a difference of $1.7 billion from Senator Grassley's figure of $427.1 billion. According to DOD officials, TAA cannot be known exactly until the end of the fiscal year. Any TAA figures published during the fiscal year are only estimates. Approximately $1.2 billion of the $1.7 billion difference between the two TAA figures is a result of the difference between the FY 1985 supplemental appropriation request of $2.164 billion which was fully reflected in the original TAA estimate and the final amount of budgetary authority received from this request of $950 million. The remaining $500 million difference is attributed to: changes in the reimbursable program where estimated income fell short of projections, changes in contract authority within the revolving stock funds, changes in the actual rate of recoveries estimated earlier in the year, and required payments to the Federal Financing Bank.

Total Direct and Reimbursable Obligations are reported by DOD at $361.7 billion for the end of FY 1985, an increase of $3.5 billion above Senator Grassley's figure of $358.2 billion. The $3.5 billion difference is comprised of $0.19 billion in trust fund obligations, $1.77 billion due to adjustments for recoveries, and $1.53 billion in payments to the Federal Financing Bank (FFB).

Lapsed Authority was reported by DOD at $2.2 billion for FY 1985, an increase of $400 million over amount of $1.8 billion used by Senator Grassley. The difference is due to lapsing contract authority within the Revolving and Management Fund Accounts. In FY 1985 the Marine Corps Stock Fund lapsed $20 million, the Air Force Stock Fund lapsed $160 million and the Navy Industrial Stock Fund lapsed $220 million.

RECONCILIATION OF UNOBLIGATED BALANCE TOTALS FOR THE DEPARTMENT OF DEFENSE AS OF SEPTEMBER 30, 1985

[In billions of dollars]

	Senator Grassley's calculations	DOD reports
Total available authority	[1] 427.1	425.4
Less: Cumulative obligations	358.2	[2] 361.7
Less: Lapsed authority	1.8	[3] 2.2
Unobligated balances	67.1	61.5

[1] This Total Available Authority (TAA) figure represents an estimated amount which differs from the actual authority due to (1) Congressional cuts in DOD supplemental requests, (2) underestimates in the amount of reimbursable funds received by DOD, (3) overestimates in the amount of contract authority which will be used by Revolving and Management Funds, and (4) underestimates of the amount of prior year obligations which will be recovered.

[2] Cumulative obligations include $187 million for trust fund obligations in the months October 1984 through May 1985, $1,767 million in recovery adjustments, and $1,535 million in payments to the Federal Financing Bank which were not included in Senator Grassley's calculations.

[3] Lapsed authority includes $401 million in lapsed contract authority which was not included in Senator Grassley's calculations.

Senator **Grassley**. OK. Let me move ahead, then, because there is another point I would like to make which would lead to a question.

UNUSED FUNDS

DOD cut $13.8 billion to make up the $5.4 billion in outlay savings. But if there is $17.3 billion in unused funds, isn't it true that for any outlay savings at all to materialize, more than $17.3 billion in budget authority would have to be cut, and doesn't that mean the outlay savings that DOD came up with may really be just paper savings, and not real at all?

Mr. **Bowsher**. No; I don't think so.

Senator **Grassley**. OK, then go into some detail on that. We don't disagree with the premise, though, that I come up with that if they say they have $17.3 billion in unused funds—if they were going to save that—they would have to have a lot more that would be cut in BA.

Mr. **Bowsher**. Well, the amount of budget authority that must be given up in an account with a slow spend out rate, like shipbuilding which has a 5-percent spend out in the first year, is much greater than in an account that has a faster spend out rate like O&M, Navy with a 70-percent first year spend out rate.

Senator **Grassley**. But there's no associated savings from unused funds?

Mr. **Bowsher**. Unused funds are a slightly different issue. If you did not have the cuts tied down by accounts, then there would have been the possibility of taking all the cuts from these unused funds. But the fact is, that you have required that cuts be done account by account. They would need to reprogram in order to use the excess funds for Gramm-Rudman cuts. That is an area that I'll have to look at. But it doesn't mean that they're going to get a free ride.

Senator **Grassley**. OK. But they can't take the $13.8 billion out of that $17.3 billion can they?

Mr. **Bowsher**. No; every year they will give up a certain amount of the funds that they have not yet obligated.

But you've got these cuts tied down by the PPA's and by the accounts so they just can't move those big sums in total. That's the difference.

Senator **Grassley**. But we would agree that if they take that $13.8 billion out of the $17.3 billion they haven't saved a doggoned penny.

Mr. **Bowsher**. Well, if they did that they would not be giving up anything that they would have been spending. That's right.

Senator **Grassley**. Now, there are an additional two points that I would like to make, and this will be it, Mr. Chairman. I ask you to help us, Mr. Bowsher, to help me to look into this—if there's anybody else on the committee interested, too. The two are related.

UNPRICED ORDERS GOING UP

First, if you analyze the obligation pattern of the last 4 months of fiscal year 1985, and compare it to the recent historical average, it appears there is a genuine attempt to push money out the door, so to speak; despite this attempt to obligate unobligated balances are still climbing very dramatically. Now, related to this point is the possible consequence that money is being obligated inefficiently and we'll continue this practice under Gramm-Rudman in an attempt to avoid sequestering.

What could happen is that money could be obligated to contracts whose negotiations are unfinished, which would remove price constraints from those contracts. You've touched on that already. And in effect it could become a windfall for the contractors, could it not?

Mr. Bowsher. I think that's a danger. The use of unpriced orders has increased. Unpriced orders were $24 billion in fiscal year 1984, and they were up to about $27 billion at the end of fiscal year 1985. We always worry when we see increased use of unpriced orders, because an unpriced order means that you've gone to contract without having it fully defined. In other words, you may have an unpriced letter contract and its use could create a danger that subsequently there will be inefficient contract negotiation and inefficient contract administration. There is no question about it.

Senator Grassley. Well, I'd like to suggest to you that that's where I could use your help, because I would say that this may have occurred in December in the rush to obligate before Gramm-Rudman would take effect.

Now, you're a former DOD budget analyst, and I hope that you can provide us with some answers to any legitimate discrepancies, not only the ones that I pointed out, but some that you might be aware of.

I think your office has had an excellent track record in finding such discrepancies, and I would like to officially request that you would assist Congress in this regard on these points that I've raised, plus probably some more that I'll be raising in the very near future.

Mr. Bowsher. We'd be pleased to do it, Senator, and I might point out that the use of unpriced orders is one of five areas where we are heavily involved in auditing the defense contracting community. We issued reports as recently as November and December, and we're going to continue to do so.

Senator Grassley. Mr. Chairman, it's my understanding that Secretary Weinberger will be up here in 2 weeks on a tentative schedule. Could we have this information before he would appear?

Mr. Bowsher. We'd be pleased to provide you any information we have on the unpriced orders.

[The following was subsequently supplied by GAO for the record:]

As part of an ongoing review of unpriced contracts, GAO provided the following information to Senator William Roth on December 20, 1985.

UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

NATIONAL SECURITY AND
INTERNATIONAL AFFAIRS DIVISION

DEC 20 1985

The Honorable William V. Roth, Jr.
Chairman, Committee on
Governmental Affairs
United States Senate

Dear Mr. Chairman:

In response to your and Chairman Jack Brooks' requests that we increase our contract pricing work we conducted a broad survey at 10 major defense firms to identify systemic problems that may adversely impact DOD's ability to negotiate fair and reasonable contract prices. We identified a number of issues we believe merit additional attention. One of those issues concerns DOD's use of unpriced contracts. An unpriced contract authorizes work prior to agreement on price. In a September 12, 1985, briefing your staff expressed interest in having GAO assess defense contracting officers' use of unpriced contracts. Accordingly, we initiated work at five major defense contractors in mid-October. We briefed your staff on December 6, 1985, on the results of our initial efforts. Enclosure I contains the information we discussed with your staff on that date.

Information we have developed along with problems identified by previous GAO and Service audit agency reports raises concern about DOD's use of unpriced contracts. The value of unpriced contracts is the highest in DOD's history--about $27 billion at the end of fiscal year 1985. And, more important, contract prices are not being negotiated in a timely manner. The latter condition (1) places the government in an unfavorable negotiating position, (2) shifts the cost risk from the contractor to the government, and (3) reduces contractor incentive to control costs.

We will continue our work at the 5 selected contractors and examine the conditions that have caused the large backlog of unpriced contracts to determine whether DOD is obtaining fair and reasonable contract prices. If you have any questions please call Paul Math on 275-4587.

Sincerely yours,

Frank C Conahan

Frank C. Conahan
Director

Enclosure

PRELIMINARY DATA DEVELOPED DURING GAO'S SURVEY OF UNPRICED CONTRACTUAL ACTIONS (CODE 396605)

BACKGROUND

Firm pricing at the time of contract placement is the policy of the Department of Defense. The fundamental objective of that policy is the achievement of fair and reasonable contract prices. However, conditions of urgency or insufficient time may dictate delay in final pricing until after contract placement. In such situations, definitization (meaning agreement on all terms and conditions, including price) must occur at the earliest possible date.

Unpriced contracts are awarded without firm prices. Unpriced contractual actions are used by government buying activities to obtain spare parts and services, implement engineering changes, initiate manufacturing, and modify existing agreements.

Four commonly used unpriced contractual instruments are described below.

- **Basic Ordering Agreements.** Basic ordering agreements are used to expedite acquisitions when specific items, quantities, and prices are not known at the time the agreements are executed, but past experience or future plans indicate a substantial need for the items or services. Basic ordering agreements themselves are not contracts; they are written understandings executed between contracting activities and contractors. Orders issued under basic ordering agreements become binding contracts when accepted by both parties. Orders can be issued either priced or unpriced. Priced orders are fully negotiated and issued with firm prices. Unpriced orders are issued with estimated or ceiling prices which cannot be exceeded by contractors without prior approval. In effect, unpriced orders authorize contractors to start work and incur costs before the negotiation and price-setting process is completed.

- **Unpriced Change Orders.** These are changes or modifications to existing contracts. The use of change orders under fixed-price contracts can result in opening up the price and delivery schedule of the contract. The price of a change order should be negotiated prior to its execution if practical. If time does not permit negotiation of a price, at least a maximum or ceiling price should be negotiated.

- **Letter contracts.** A letter contract is a written preliminary contractual instrument that authorizes the contractor to begin immediately manufacturing supplies or performing services.
- **Provisioned item order.** A provisioned item order means an unpriced order issued under a contract which sets forth the Government's requirements for provisioned items. Provisioned items include spare parts and support equipment.

DOD'S USE OF UNPRICED CONTRACTS

The following chart shows that the use of unpriced contracts has increased in recent years in the Navy and the Air Force but declined in the Army.

UNPRICED CONTRACTS BY SERVICES
($BILLIONS)

SERVICE	1984	1985
ARMY	$ 5.2	$ 3.2
NAVY	7.8	10.7
AIR FORCE	10.8	12.9
TOTAL	$23.8	$26.8

UNPRICED CONTRACTS BY TYPE ($ billions)

	Air Force		Navy		Army	
	1984	1985	1984	1985	1984	1985
Letter contracts	$2.4	$3.1	$2.1	$3.0	$1.3	$ .6
Contract modifications	2.8	2.7	1.2	1.5	.3	.3
Basic ordering agreements	3.1	3.6	4.5	6.2	2.3	2.0
Provisioning item orders	2.2	3.2				
Other	.3	.3				
Total	$10.8	$12.9	$7.8	$10.7	$3.9[a]	$2.9[a]

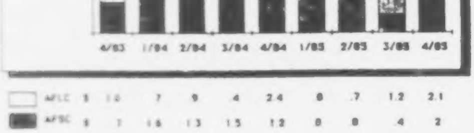
[a] Does not reconcile with growth chart because only selected major Army buying activities were included in this analysis while the growth chart includes all Army unpriced contracts.

YEAR END USE OF UNPRICED CONTRACTS

Our preliminary work indicates that a number of Navy and Air Force buying activities issued a large amount of unpriced contracts during the last quarter of the fiscal year.

We found that the Navy's Aviation Supply Office in Philadelphia issued 8,000 unpriced actions during fiscal year 1985 with a value of $2.8 billion. Of that total, 2,000 actions valued at $1.2 billion were processed in the fourth quarter.

The following chart shows the value of unpriced contracts issued by quarter during fiscal years 1984 and 1985 by the Air Force Systems Command (AFSC) and Air Force Logistics Command (AFLC). There was a significant increase in the last quarter of both years, except for AFSC in fiscal year 1984.



STATUS OF UNPRICED CONTRACTS AT SELECTED CONTRACTORS (As of 9/30/85)

	Value ($ millions)	Number of actions
General Electric (Evendale)	$ 235	228
FMC (San Jose)	42	40
McDonnell Douglas (St. Louis)	1,557	1,950
Texas Instruments (Dallas)	793	170
Westinghouse (Baltimore)	1,120	531
Total	$3,747	2,919

AGING OF UNPRICED CONTRACTS AT SELECTED CONTRACTORS

Unpriced contracts should be definitized (meaning reaching agreement on all terms and conditions, including price) at the earliest possible date. Service regulations generally recognize a period of 180 days for definitizing unpriced actions. By aging the unpriced contract inventory at 5 selected contractor locations, GAO found that a substantial dollar amount had not been definitized within the 180-day limit. Forty-five percent of the unpriced contracts had not been definitized a year (360 days) or more after the contract had been placed.

AGED VALUE OF UNPRICED CONTRACTS ($ MILLIONS)

		Days since order placed			
	Total	<180	181-360	361-540	>540
General Electric	$ 235	$ 93	$ 21	$ 88	$ 33
FMC	42	7	12	10	13
McDonnell Douglas	1,557	319	190	409	639
Texas Instruments	793	579	11	99	104
Westinghouse	1,120	574	247	192	107
Total	$3,747	$1,572	$481	$798	$896

PROBLEMS IDENTIFIED DURING PRIOR AUDITS

On September 18, 1985, we issued a report (NSIAD-85-155) dealing with the purchase of F-16 support equipment from General Dynamics. GAO found that the Air Force's use of an unpriced contract modification without timely price negotiations resulted in excessive prices for many of the items purchased. The service audit agencies--Army Audit Agency, Naval Audit Service, and Air Force Audit Agency--have issued several reports dealing with unpriced contracts. Listed below are some of the problems that have been associated with the use of unpriced contracts.

--Excess profit rates. Fixed-price profit rates have been allowed on contracts that were virtually complete when negotiations took place. In such cases the contractors' costs were known, and in essence, the situation had resulted in a cost-type contract. The profit rate for cost-type contracts is normally lower than for fixed-price contracts.

--Unpriced contracting has become routine rather than for unusual or urgent situations.

--Untimely negotiation/definitization.

--Use of unpriced actions did not appear justified.

--Late definitization reduces/eliminates contractors' risk normally associated with fixed price contracts. Risk is shifted to government.

--Orders priced after items delivered to government.

--No incentive for contractor to control costs.

DOD IS CONCERNED

During a meeting held on November 7, 1985, DOD officials expressed concern about the growing number and dollar value of unpriced contracts. The value of unpriced contracts is the highest in DOD's history and there is an upward trend. Because of the concern within DOD, the Air Force and Navy have established goals to reduce both the number and value of unpriced contracts issued as well as the number and value of unpriced contracts on hand. The Navy wants to reduce the number of unpriced contracts issued in fiscal year 1986 by 20 percent and the outstanding dollar value by 30 percent compared to the end of fiscal year 1985 numbers. The Air Force wants the dollar value of unpriced actions issued in fiscal year 1986 to be no more than 10 percent of the total dollars obligated by the Air Force in fiscal year 1986 and the dollar value of unpriced contracts on hand at the end of fiscal year 1986 to be no more than 50 percent of the amount on hand at the end of fiscal year 1985.

Senator **Grassley**. And one further thing, Mr. Chairman. I'll address you, because I'm finished with my questions. If in fact, like because of some sort of subterfuge, you know, the Commodity Credit Corp. would be affected by $1.3 billion, we're talking about real solid dollars there that are really going to be cut. If we don't observe this defense budget as closely as we can, and police it as closely as we should, and use the abilities like those that are in the General Accounting Office, and probably in our own staffs to a considerable extent, we could be dealing with a lot of phantom dollars in the defense budget so that there's no cuts accomplished at all.

And that's what I hope now with Gramm-Rudman, that the 50-percent guideline, that that indeed ends up being a real 50 percent.

Chairman **Domenici**. We had clearly intended it as we worked on the law, and we expect everybody to abide by the rules. We hope we didn't draw the statute such that there wouldn't be any real savings from any major part of this Government, defense or otherwise.

Senator Moynihan.

SEQUESTERED MONEYS WILL COME FROM ONE-QUARTER OF BUDGET

Senator **Moynihan**. Thank you, Mr. Chairman. I would like to pursue a little bit the line of inquiry I had with the Director of the Office of Management and Budget.

And that's to get some feel for what is it that you're going to have to take the sequestered $60 billion or so out of if it comes to sequestering in fiscal year 1987. And Dr. Miller gave us the numbers that you found, in this budget, the current one, $105 billion in domestic—nondefense programs, and $109 billion in defense.

Together that's just roughly 20 percent of the budget, and then he mentioned that the President had exempted from sequestration $61 billion in military personnel accounts. I suppose that simply means manpower.

Well, you put that back in, and you have about a quarter of the budget. I assume that next year you're going to send us a budget that will be under $1 trillion. Isn't that what you're required to do? Do you have any judgment on that?

Dr. **Penner**. Fortunately, we don't have to send you a budget. We will, however, be sending you a baseline. I suspect that baseline will creep above $1 trillion, but I can't be sure at the moment.

Senator **Moynihan**. Creep above. So the prospect if it were to come to that sequestration moment, you're going to be taking the moneys required to get down to $144 billion out of about one-quarter of the budget, isn't that right?

Dr. **Penner**. These are very crude estimates, Senator. But we have roughly estimated about $110 billion in the nondefense area, and about $165 billion in the defense area

Senator **Moynihan**. Yes; I found about $275 billion. And that is likely to be about one-quarter of the budget.

Dr. **Penner**. A little more, yes.

Senator **Moynihan**. A little more. You think you'll go up to a trillion fifty or something like that?

Dr. **Penner**. We have just barely started our work.

Senator **Moynihan**. You don't have it.

And that $260 or $270 billion of $275 gets very close to a 25-percent cut, does it not?

Dr. **Penner**. We've calculated that, too. Again, I don't want to imply the right number will be $60 billion. But if for some reason it turned out to be, that it would imply about an 18-percent cut for defense programs, and about 25 percent for the nondefense programs.

Senator **Moynihan**. That's what I've been trying to estimate.

Chairman **Domenici**. Senator, would you yield for a clarification?

Senator **Moynihan**. Sure.

Chairman **Domenici**. Is that outlays, all those percentages and those numbers?

Dr. **Penner**. Those are the percentages that would be applied to budgetary resources. To determine these percentages, the outlay base would be on the order of $275 billion.

Chairman **Domenici**. Thank you very much.

Senator **Moynihan**. I guess we really have to start talking outlays, if we're talking deficits, don't we?

Mr. **Bowsher**. Absolutely.

Dr. **Penner**. Yes.

Senator **Moynihan**. Now, this is your number. It seems to me an honest number. Of course, it's honest if you give it to us. I mean it's a number you can honestly say you've got some reason to support; you put it together with some measure of confidence.

We're talking, if we go to that sequestering procedure in fiscal year 1987 of a 25-percent cut in the nondefense portion, and an 18-percent cut in defense.

I think, Mr. Chairman, those are the numbers we've been talking about.

Chairman **Domenici**. Without revenue.

Senator **Moynihan**. Without revenues, yes. Obviously without revenues.

THINGS ARE SENSITIVE TO SEQUESTER

Dr. **Penner**. I should perhaps emphasize, Senator, how extraordinarily sensitive the sequester amount is to things like the economic forecast, and legislation.

Senator **Moynihan**. Like the interest rates and the growth rates.

Dr. **Penner**. A 1-percent error in forecasting outlays, for example, would be about $10 billion. That translates into about a 5-percent error in forecasting the deficit, if it is around $200 billion. Furthermore, if you're right that the sequestered amount will be $50 billion to $60 billion, that's almost a 20-percent change in the percentage reduction you need. So the thing multiplies.

Senator **Moynihan**. Wait until we get through with tax reform. I thank you very much. I think that's the range we are dealing with. Mr. Bowsher, would that be about your estimate?

Mr. **Bowsher**. Yes. I think you're in the ballpark.

Senator **Moynihan**. Thank you both.

Mr. Chairman, might I say that the next time I think it should be their turn first. [Laughter.]

Chairman **Domenici**. I don't know if we'll ever have it this way again.

Senator Hollings, I think you're next.

Senator **Hollings**. Well, on that point, Senator, let's elaborate and find out. Mr. Penner, does that 18 percent on defense and 25 percent on nondefense envision an increase of $75 billion in revenues from 1986 to 1987. I think CBO estimates that, does it not?

Dr. **Penner**. As I said, Senator, we are really just beginning our work on estimating revenues and outlays for fiscal year 1987 under a new economic forecast. I think anything that I said about that could probably be misleading right now.

Senator **Hollings**. I just don't want to be misled about the 18 and the 25 percent. In other words, the figure that you were giving Senator Moynihan and the committee contemplates no new revenue increase from 1986 to 1987.

Dr. **Penner**. The figure I gave was just a purely hypothetical sequester amount.

Senator **Hollings**. Just to sequester without——

Dr. **Penner**. If you go back to our August report, just to give you an idea of the orders of magnitude, at that time the revenues went up about $68 billion between 1986 and 1987. But that was a different economic projection than we will be coming out with.

REVENUES INCLUDED IN SEQUESTRATION FIGURES

Senator **Hollings**. So would you amend those percentages in the light of that $68 billion or not? I'm not trying to catch you; I'm trying to make sure we've included revenues in that 18 and 25 sequestration figures.

Dr. **Penner**. Well, sir, let me repeat: I just took the $60 billion as an example. In fact, it was Senator Moynihan's number

Senator **Hollings**. I'd take the same figure.

Dr. Penner All right.

Senator **Hollings**. But does it include the revenues? That's all I want to know.

Dr. **Penner**. That is the excess deficit amount. Yes, sir.

Senator **Hollings**. That's the excess deficit amount over and above some $68 billion or $70 billion or whatever the revenues are?

Dr. **Penner**. That is correct.

Senator **Hollings**. Good. I just wanted to make sure it included that big increase in revenues, because that came out in the debate when we were having this thing.

Let me compliment you and Mr. Bowsher. Mr. Bowsher, I'm glad to speak to a member of the executive branch. [Laughter.]

If they find you belong to me, I want you to draw me up a budget.

Mr. **Bowsher**. OK.

Senator **Hollings**. But both of you all are really professionals—and this committee and the entire operation. There's no question that Gramm, Rudman, and Hollings never contemplated the immensity of this exercise. And the more we went down that road, the latter part of September, October, November, December, the more we had the help of your two offices, and also of Mr. Miller of OMB. And due to that professionalism we were able to make some order out of chaos. And I do thank you, Dr. Penner, particularly for costing out our budget that was proposed, because that was done in very short order, and had to be given as estimates.

I've found, Dr. Penner, that CBO is—and I look at the group of 44 economic forecasters—better than Chase Econometrics, Data Resources, just go right down, Wharton's, and all the rest. You've got a better track record in the Congressional Budget Office than all the 44. And I think that ought to be said on the record, and I do appreciate your work and compliment you.

CONTRACT PENALTY CLAUSES

Mr. Bowsher, with respect to looking at those figures on defense, look also at the penalty clauses now. Our Navy friends are pretty astute. Contemplating that they might have to cancel, they put in these extravagant penalty clauses, so they can say, wait a minute, we don't have to cancel that contract in order to comply with the sequestration.

That's another as you said, danger to be watched. If you don't mind, in addition to unpriced orders, let's look at penalty clauses.

Mr. **Bowsher**. Yes; we're going to be looking at penalty clauses, and termination costs. Also I think one thing we have to be watching is whether there's a rush to multiyear contracting over and above what the Congress has approved. I think there is going to be some efforts—and it's only natural, by some program people to try to do things that get their program somewhat outside the cutting game.

Senator **Hollings**. Right. Let's don't start a game. Let's try to start a discipline here. If we ever develop the discipline: you won't ever hear of Gramm-Rudman-Hollings again, which is our desire.

Thank you, Mr. Chairman.

BUDGET GIVES LEEWAY FOR ERROR

Chairman **Domenici**. Senator Exon. Senator, before you proceed and before Senator Moynihan leaves, let me say I believe this statement belongs in the dialog that you had with reference to possible difficulties we will have if our economic projections are not accurate.

The act does give us some leeway for error. I think we fixed it at $10 billion so that in each of the years if we can have $10 billion-plus and still come within the mandate of the law.

Mr. **Bowsher**. That's correct.

Chairman **Domenici**. We settled on that. At $144 billion, we can be at $154 billion when we take that snapshot.

Senator **Moynihan**. Mr. Chairman, may I make one caveat, though. If Senator Hollings keeps telling the GAO how much better their economic forecasts are than DRI, and CBO, do you think they're going to continue to work for one third the pay those people get? [Laughter.]

Senator **Hollings**. All these folks are getting low pay.

Senator **Lautenberg**. Also, if you don't mind, there's a company called ADP that has an economic forecasting service called Towns & Greenspan, Mr. Hollings.

Chairman **Domenici**. Do you have some interest in that?

Senator **Lautenberg**. Not any more.

Chairman **Domenici**. I see. All right.

Senator **Hollings**. On that point, there's a Mr. Mike Dingman—he was head of Signa Corporation. They've just merged with Allied. I had dinner with him. He was in charge of the Grace Commission on Government employees, and employees and their character and their abilities. And he said, "Yeah, the assistant secretaries, undersecretaries, he wouldn't hire any of them " He said when they got down to you folks, directors, GS–19's, 18's, 17's, he said private industry would pay them three and five times more. And that's why we see them come here and move on to something else.

Senator **Moynihan**. That's a fact.

Chairman **Domenici**. Senator Exon.

Senator **Exon**. Mr. Chairman, thank you very much. Let me join my colleagues in welcoming you and I know you will be back frequently, and we appreciate your forthcoming attitude very, very much.

I have been listening with keen interest and I hope that you heard the question that I asked the previous witness, and it was about agriculture, and the more I hear of what is going to happen to agriculture in this, I probably should be elated that agriculture is only taking a 4.3 sequestering under the present plan.

Agriculture is somewhere between 2 and 3 percent of the total Federal budget, and there was a general conception that when this mess that we are in got going, that it was going to be kind of across the board.

It seems to me that it is anything but across the board, and I have also listened, Dr. Penner, to your indication that—these are not your words, but it went through my mind, "We ain't seen nothing yet."

CUT WILL FALL ON COMMODITY LOAN PROGRAM

If I am concerned about a 4.3-percent reduction to match about a $12 billion 1986 cut, I take it from the figures that you have been giving here—and correct me if I am wrong—when we are looking at about $60 billion next year, that is going to be about five times the cut and is going to fall, once again, on the Commodity Loan Program. Because as you know, in the agricultural sector, the Food Stamps, and the Women, Infant and Children Programs are hurt, and is it true that if a farmer is planting out there today, after sweating out and not being happy with the farm program that we passed, with a great deal of pain, he had better do some figuring, that if sequestering would set in next year, that that $1.92 loan price per bushel for corn, that has dropped to $1.84 here, and if it is another 25 percent next year—my arithmetic serves me—that 75 percent of that is about $1.38 per bushel.

It could be, with that additional $60 billion sequestering in 1987. Are those figures basically accurate?

Dr. **Penner**. Well, it would take a very large cut. The only footnote I would add is that the Department of Agriculture has some freedom in just how they choose to administer the cut that they take. But if they take it in terms of the loan rate, then, I trust your arithmetic, sir.

Senator EXON. Well, I would simply point out that the Congress, in its lack of wisdom, gave the Department of Agriculture great latitude, and we saw what action they took.

As we all know, the administration was supposedly upset about the total of $52 billion, that the Agriculture Program, Commodity Program, was going to cost for the next 3 years.

It looks to me like that regardless of what the agricultural 5-year program, or 3-year program entails, it is going to be rather easy for the administration to use Gramm-Rudman to make massive reductions in what was spelled out to the contrary in the agricultural bill.

And the point you are making is that if the present course of action is maintained, we could see that corn figure at, loan rate figure at about $1—if it is about 25—I assume that commodity prices fall within that 25-percent category that you explained in answer to the question, I believe, by Senator Grassley, or someone.

You were talking about the different categories, and——

Dr. PENNER. Yes; the Community Credit Corporation programs fall in that nondefense category.

STUDENT LOANS IN SPECIAL CATEGORY

Senator EXON. All right. See if you can clarify this, either one of you can clarify this. This is my last question.

I pointed out earlier that I could understand a sequestering on a basic outlay such as the deficiency payments—spending money on defense, spending money on salaries. Those are outlays and it is gone.

When we get into the commodity programs, of course these are loan programs, and history has shown that a high percentage of those have been paid back.

I take it, though, that agriculture is not protected even on its loans, under the commodity programs. As spelled out, in answer to the questions that I asked Dr. Miller.

What other loans are exempted? I understand, for example, that student loans would not receive the cuts that the Commodity Loan Program has forced upon it by sequestering. Is that right?

Student loans are treated differently than commodity loans to farmers?

Dr. PENNER. As a general rule, there is an attempt in the legislation to sequester any kind of so-called budgetary resource, whether it is lending authority, guarantee authority, or new budget authority.

There are certain limited areas where there are either exemptions or what we have come to call special rules. The student loan is one program that fits into the special rule category, and that is really because of the nature of its structure.

It is very hard to think of what a 4.3-percent across-the-board cut might mean for that program. Therefore, we were given special instructions as to how much the origination fee paid by the student had to be raised, and how much the interest rate subsidy to the banks could be lowered. I think within the great population of loan programs, however, that one is very much an exception, rather than the rule, as to how it was treated.

Senator **Exon**. I have a followup question. I saw Senator Boschwitz, you were shaking your head when I said that. What about a loan that the Government makes on a home? Is that affected the way an agricultural commodity loan is?

Dr. **Penner**. The gross loan limits, where they exist, are taken down.

Senator **Exon**. And Small Business Administration?

Dr. **Penner**. It would be the total amount they can obligate. But they have quite a bit of choice in how they choose to administer that, just as I said the Department of Agriculture has with the commodity loan.

Senator **Exon**. With the commodity loan. Thank you both, very much.

Chairman **Domenici**. Senator Lautenberg.

Senator **Lautenberg**. Thank you, Mr. Chairman. I appreciate the opportunity to catch up with these two distinguished witnesses. On other occasions, I have noted their high degree of professionalism Mr. Penner, and Mr. Bowsher, you have both done an admirable job.

ESTIMATED $90 BILLION OF UNCOLLECTED TAXES

Do either of you have any cause to disagree with the Treasury estimate about the amount of uncollected taxes each year? An estimated $90 billion was for 1985.

Dr. **Penner**. Obviously, Senator, that is a very difficult number to get at, by definition, since it does involve illegal activity and so-called hidden or underground economy. Therefore, I think you have to take any estimate of that with a grain of salt, although that in no way demeans their efforts to narrow it down as closely as they can.

Senator **Lautenberg**. Mr. Bowsher, do you have any——

Mr. **Bowsher**. Our people have done work in that area and by and large they think that number is in the ballpark.

Senator **Lautenberg**. OK. Well, now, we are going to be cutting $140 million from the IRS budget altogether, $36 million specifically from returns processing. We know what has already happened. The administrative chaos at the IRS facility in Philadelphia is an example of the problem that developed even before these cuts.

We are also going to be cutting $34 million out of the Customs Service which includes a significant amount of collection activity. Do you agree?

Mr. **Bowsher**. Yes.

CUTS COULD IMPAIR ABILITY OF AGENCIES TO WORK

Senator **Lautenberg**. Then there are other agencies whose work results in net revenue gain for the Federal Government. The Securities and Exchange Commission collects more in fees and other payments than it spends.

These cuts are going to impair the ability of these agencies to work reasonably efficiently, to do their job.

I ask each of you about the effects of the cuts in your own departments. Will they have a negative effect or are the cuts so de minimus that it does not matter?

Mr. **Bowsher**. Oh, we will have to cut back on some things, no doubt about that.

Senator **Lautenberg**. Are your people generally taking it easy now? I mean, is there lots of spare time around so that everybody——

Mr. **Bowsher**. This is not a good time to ask that question, Senator.

Senator **Lautenberg**. I am trying to make my point with a degree of irony here. As a former businessman, I would have to tell you, that if it were my business, and I had 90 billion dollars' worth of receivables out there, I would sure not fire the collection department, I can tell you that, because that is no way to ensure that you are going to be in business the year after, or in subsequent years.

Dr. Penner, while I was out of the room, did you—or did I miss it—did you forecast what the deficit might be for 1987?

Dr. **Penner**. No, sir; we have just begun work on that now so I could not even speculate on that.

Senator **Lautenberg**. No hipshooting at all? Mr. Bowsher?

Mr. **Bowsher**. No; we do not estimate. We leave that to CBO.

Senator **Lautenberg**. That is what I thought.

Do you have any reason—and I do not want to ask you to say anything that you do not feel comfortable with. Do you have any reason to think that Mr. Miller's estimate of close to $200 billion, over $190 billion, could be significantly off the mark?

Dr. **Penner**. Right now I do not. But if you had asked me 4 weeks ago, I might have been $25 billion off in the estimate we finally came up with for 1986. Again, these are just very highly volatile numbers.

AGRICULTURE ACCOUNTS FOR LARGEST CHANGE IN ESTIMATE

Senator **Lautenberg**. Well, what caused the change, in your view, in these last several weeks here?

Dr. **Penner**. Let's go back to November, when for the purposes of the conference, we provided $194.6 billion as our estimate of the deficit. Usually, when there is such a big change, it is because of errors in macroeconomic forecasting. That was not the case this time.

Our forecast is very similar to what it was before. It has deteriorated a little but in terms of our estimate of money income, but that accounts only for about $10 billion of the $26.2 billion change. The remaining $16 billion can be attributed to legislative actions, and to technical reestimates of spending. The largest change goes back to agriculture, which has gone up $10 billion. The farm bill that was passed was more expensive than current law for 1986. We were operating under current law for the November estimate. It was $2 to $3 billion higher than current law.

The deterioration in farm prices, though, is the major cause. That caused a $7 to $8 billion increase in spending. There is also a change in our outlay estimate for national defense. That has gone up almost $8 billion. If you remember, in the Balanced Budget Act baseline, when you do not have an enacted full-year appropriation, you go back to last year's appropriations, which is what we did in November. The new appropriation adds about $4 billion and the rest of the $8 billion is the result of the Pentagon spending the money faster than we expected them to.

Senator **Lautenberg**. Mr. Chairman, if you will indulge me for just a brief moment and I will finish this up.

Chairman **Domenici**. Sure.

Senator **Lautenberg**. In response to Senator Moynihan's question, Mr. Penner, I think I heard the number 18-percent reduction possible in military next year, and 25 percent in nondefense.

At what point do resources become so inadequate, so that we question whether we can meet our different responsibiities? If an 18-percent defense cut would be devastating, a 25-percent nondefense cut would be terminal.

What do you see as the way around this, now that we are on this glidepath?

Dr. **Penner**. I think the whole intent of the legislation is to push forward numbers of that sort, with the goal of provoking a different kind of budget plan, a different kind of approach to the problem. I think that no one would like to see a sequestration go into effect at those levels.

Senator **Lautenberg**. This is the cold shower after a bad night out. It is a brutal awakening. I thank you, Mr. Chairman, and I thank both these witnesses for the informative testimony they have supplied us with.

Chairman **Domenici**. I thank you for your patience today. I have five questions but I believe I am going to submit them to you and let you answer them. I think perhaps a week is adequate on our part; if it takes you that long, that is all right with me.[1]

I would answer the distinguished Senator from New Jersey with reference to running a business. He is right. Many of us are quite sure that our Government will never be run as a business, and I assume you are reaffirming that conclusion the longer you are here.

But, you know, the IRS issue is an interesting one because I do not think we can handle Gramm-Rudman in that manner, unless one were to say "You're going to treat IRS the same also, or you're not going to get a deficit reduction package of $35 or $40 billion."

Now obviously, if you do not want the Gramm-Rudman approach, clearly, your question taken in isolation is absolutely right; we should not do that.

But when we are confronted with either "You take that or you don't get the rest," obviously, we have to analyze whether it is worth not having Gramm-Rudman.

FIRST DEFICIT REDUCTION SEQUESTRATION A TRIAL

On the other hand, it appears to me that this first deficit reduction sequestration was really kind of a trial run. It is small, compared to what we are facing by way of deficit reduction in fiscal year 1987, but it gives us all a pretty good glimpse of the arbitrariness of a $60 billion cut with everything included.

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[1] See written questions to Dr. Penner and the responses, p. 119.

It was not intended by very many people to be carried out. I think you have heard that today from a number of people who worked very hard on it.

It was meant to be used only if the leadership of Congress and the White House could not find an alternative. I think that is the way you just described it, Dr. Penner.

At least now there is a serious penalty that will be imposed, if we do not get our heads together and exercise the leadership and get rid of the gridlock that has existed around here.

Senator **Lautenberg**. Mr. Chairman, I have always been opposed to the death penalty.

Chairman **Domenici**. And I have been kind of for it so I guess I should stick with Gramm-Rudman.

PRIORITIES BEING AVOIDED

Senator **Lautenberg**. Seriously, in response, exactly what you attribute to be a primary asset of the Gramm-Rudman technique, I think is the weakness. We avoid setting priorities. We had a reconciliation bill. You worked very hard in this committee to get it. It was a proposal that would have saved some important funds out there.

There are two sides to any financial statement—you have expenditures and you have revenue. No one's putting forth a tax increase, at least here, as the way to solve the problem, but we ought to get the money that is owed us. The Gramm-Rudman cut makes that more difficult.

And to me that is the essential oil that keeps this machinery going. You can not have an external defense system operating unless you have the resources to attract, recruit and train people, and to buy up-to-date equipment.

So, to me, a terrible result of this legislation is that we avoid the need to prioritize. Perhaps, the cold shower will awaken some other approach, but the one that we have taken so far, I think, Mr. Chairman—with all due respect to my colleagues who voted for it—I think it was the wrong way to go.

I see it as an abdication of responsibility. That is one Senator's opinion; that is all.

Chairman **Domenici**. Let me again thank both of you, and your staff, and particularly the staff of CBO. As we went through the conference we needed your assistance and I do not think I have had a chance, publicly, to thank you and them for all their work. We stand in recess until the Chair calls another meeting.

[Whereupon, at 5:13 p.m., the committee was recessed, subject to the call of the Chair.]

WRITTEN COMMITTEE QUESTIONS TO OMB DIRECTOR MILLER AND THE RESPONSES

RESPONSES TO QUESTIONS

OF

JAMES C. MILLER III

BEFORE THE

SENATE BUDGET COMMITTEE

JANUARY 22, 1986

Question 1. Gramm-Rudman exempts certain programs, including Social Security and many poverty programs. Clearly, by exempting these, the rest of the budget will be forced to make up the difference when the sequestering order is given. What is the difference between the percentage of across the board cuts needed with these exemptions, as opposed to without them?

Answer The Act exempts a large number of programs from the sequestration process. For illustrative purposes, we have attempted to add the estimated FY 1986 outlays for Social Security and the major exempt domestic programs to the sequestrable base, and have assumed that the programs subject to special sequestration rules remain subject to those rules. As a rough approximation, this approach produces a domestic base (current base plus the exempted programs) of $412 billion, and thus the sequestration percentage necessary to realize one-half of the outlay reductions from domestic programs would be 1.2 percent.

Question 2. Gramm-Rudman will not effect every state and region of the country identically. Because of different economic, geographic, demographic and other factors, each state depends to a different degree on each of the Federal programs which are to be cut (assuming a sequester is needed). Idaho -- and many other Western states -- do not rely as heavily as other states on the federally-assisted poverty programs which are exempted from cuts, and rely *to a greater degree* on those programs which *will be cut* (programs in the Interior, Agriculture, Commerce and Transportation Departments, for instance). Taking this into account, and considering the large number of Federally-owned acres in Idaho -- and other Western states, how much of a difference will there be between Gramm-Rudman's effect on Idaho and the West and its effect on the more populous eastern states?

Answer We are unable to answer this question. There are approximately 850 budget accounts subject to sequestration and several thousand "programs, projects and activities" from which the outlay reductions must be taken in a uniform manner. In order to answer the qustion, we would have to have a breakdown of the impact of the reductions by State for each account and PPA. We do not have such information.

Question 3. How will this difference be affected by the re-inclusion of Social Security and the other exempted programs in the Gramm-Rudman sequestering procedure?

Answer As noted in response to Question 2, we do not have the ability to determine the effects of the sequestration on a state-by-state basis. Therefore, we cannot answer this question.

Meat Processing Question:

Question 4. Under Gramm-Rudman, the USDA might have to furlough employees at the Department's Food Safety and Inspection Service. The meat and poultry businesses cannot operate unless inspectors are present in their plants. It would appear that, if these employees are furloughed, the number of inspectors available to carry out the mandate of the Federal Meat Inspection Act and the Poultry Inspection Act will be reduced. How is this shortage to be handled? Will inspection regulations be relaxed -- thereby lessening the public's health protection, or will businesses be forced to close or limit their hours of business to accommodate the shortage of Inspectors?

Answer We are working with the Department of Agriculture to review the impact of the FY 1986 sequestration order on the Food Safety and Inspection Service and determine how the required outlay reduction can best be accomplished to minimize inconvenience to meat and poultry firms.

We have not reached a **final decision** concerning how the outlay reductions will be accomplished for this program. But I can assure the Committee that the inspection standards will not be relaxed as a result of the passage of the Act and that the Department is exploring every avenue to prevent reduction in the hours or other disruptions of the normal business operations of the firms subject to FSIS inspection.

Question 5. Are there other public safety agencies in similar situations?

We are unaware of any public safety program whose ability to protect the public fully will be adversely affected by the required outlay reductions during FY 1986. Concerns about the application of the Act to such agencies in FY 1987 and beyond serve to emphasize the importance of Congress's taking timely action to reduce the deficit below the target amounts and thus avoid the need for application of the uniform across-the-board outlay reductions the Act otherwise would require.

Question 6. In 1982, Congress passed the Surface Transportation Assistance Act which included a 5-cent per gallon increase in the Federal tax on gasoline (bringing the total tax to 9-cents per gallon). President Reagan and many members of Congress, including this Senator, supported the tax increase and promoted it among our constitutents with the understanding that those new revenues would be used to build and maintain the Nation's Federal-aid highway system. Under Gramm-Rudman, the highway program will be reduced in FY 86 and a more significant reduction is anticipated for FY 87. It appears likely that beginning in FY 87, our highway spending authority under Gramm-Rudman will be reduced to the point that we're collecting significantly more revenue from the gasoline tax than we're allowed to spend on highways.

Do you support the inclusion of the Highway Trust Fund and other Trust Fund accounts in the deficit reduction measures required under Gramm-Rudman?

What effect do you believe such actions may have with regard to the Adminstration's endorsement of the user fee concept? Won't people be reluctant to support a user fee if they know that expenditures from a user fee-funded acount may be limited in order to make the deficit appear to be something les than it actually is?

Answer

In enacting the Gramm-Rudman-Hollings Act, Congress carefully selected those trust fund accounts that would be exempt from sequestration and those accounts, including the Highway Trust Fund, that would be subject to sequesteration. I agree with the conclusion Congress reached in December that this fund should be included in the sequestration base.

The Act expressly made the use of offsetting collections and receipts subject to sequestration, whether they are paid into a trust fund or other accounts. I believe this treatment was appropriate. Under the Act, user fees will continue to be paid into the Highway Trust Fund, will remain in the Fund, and thus will be available only to support the functions authorized by the organic legislation that established the Fund. The sequestration applies to the annual obligation limit of the Fund, and thus has the effet of postponing by some small amount the use of the receipts in the Fund. The purpose of the user-fee funded accounts therefore will be fully preserved. Our legislative and budget proposals would fully utilize the user fee revenues for 1987-1990 and would not, as may be implied, result in collections that exceed outlays.

Question 7. Senator Kassebaum has introduced legislation, S., 1979, to exempt the FAA Trust Fund from the Gramm-Rudman deficit reduction requirements. Do you support this legislation?

Answer Although the Administration has not formally taken a position on Senator Kassebaum's proposal, I would anticipate that our position would be consistent with the letter that we sent to Congress during the debates on Gramm-Rudman-Hollings, in which we strongly opposed efforts in the House of Representatives to exclude the FAA Trust Fund from the sequestrable base.

Question 8. If we find that Gramm-Rudman budget restraints limit significantly our ability to spend the highway revenues we collect, would you support a reduction in gasoline taxes which would allow the states to raise the revenues they would no longer receive from the Federal government?

Answer I would oppose this proposal. As noted above, sequestration only postpones the use of these funds. Moreover, since 1983, the Highway Trust Fund has been headed toward and then entered a deficit position, because budget authority has exceeded user fee revenues, often by substantial amounts. Within the last few days, the Administration has submitted to Congress proposed legislation that would make expenditures from the trust fund deficit-neutral; that is, anuual trust fund spending would be set at the level of estimated annual revenues.

Question 9. Do you have any intention of recommending that interest paid on the cash balance in the Highway Trust Fund be diverted to the General fund or any account other than the Highway Trust Fund?

As a review of our FY 1987 budget proposal demonstrates, the Administration has no intention of recommending such an approach.

WRITTEN COMMITTEE QUESTIONS TO CBO DIRECTOR PENNER AND THE RESPONSES

Accounts With No Outlay Reductions

Questions

The report to GAO notes that in a few instances, the uniform percentage reduction of budgetary resources would not produce any outlay savings this year or in any future years.

1. Would you please explain this problem further and cite some of the major examples?

2. Do you believe that it is consistent with Congressional intent that these programs be spared any outlay reduction in FY 1986?

3. In the future, how might we insure that outlays for all programs be reduced by a uniform percentage, unless specifically exempted?

Answer

We identified certain accounts which have more in budgetary resources than they can reasonably be expected to obligate in FY 1986. These are programs for which Congress has "over-appropriated," providing more in budget authority or higher loan limits than needed. In these cases, a 4.3 percent cut in budgetary resources would not affect FY 1986 outlays.

For example, the public housing operating subsidy account in function 600 has $1.5 billion in budget authority available in FY 1986. But HUD expects to obligate only $1.3 billion. Reducing new budgetary resources by 4.3 percent would still leave this program with more than it needs for FY 86 obligations and therefore would not affect outlays. This also occurred in some loan programs, where Congress has established a limitation that is higher than expected activity.

To achieve a 4.3 percent reduction in FY 1986 outlays for these programs, either the budgetary resources would have to be cut by more than this amount, or CBO and OMB estimates of program levels would have to be substituted for those provided by the Congress. Neither of these options is permitted by P.L. 99-177.

Contributed Funds Exemption

Question

1. I understand that in defining the budgetary base for the sequester order, CBO and OMB exempted spending from contributed funds. I am told, for example, that spending in the "Rivers and Harbors Contributed Funds" account, which is funded from voluntary contributions from localities towards the financing of Corps of Engineers' water projects, was fully exempted in your report. Please explain your rationale for exempting this account.

2. How much of the budgetary resource base did you exempt as contributed funds?

3. An analogous situation to the Corps of Engineers contributed funds arises in NASA's Shuttle account where private companies pay costs associated with launching satellites. I understand that CBO and OMB did not exempt spending related to these contributions. Please explain your rationale for not exempting this account, particularly in light of the Corps' exemption.

Answer

Under the "voluntary contributions" exemption provided in Section 255(g)(1) of P.L. 99-177, we did not sequester resources in a number of accounts where nonfederal entities "contribute" funds for use by the federal government for their specific benefit--for example, Rivers and Harbors Contributed Funds of the Corps of Engineers, the Reclamation Trust Funds of the Bureau of Reclamation, and Miscellaneous Contributed Funds of the Soil Conservation Service.

We considered these slightly different in nature from user fees charged for launching satellites, for obtaining patents, etc.--in that the contributed funds accounts serve as a conduit for the voluntary expenditures of nonfederal funds, while the others represent generalized user fees.

The accounts exempted did not constitute a large portion of the budgetary resource base. Approximately $910 million in new budget authority was exempted in 28 budget accounts.

Insurance Funds

Questions

Some people have raised questions about the treatment of insurance funds, like FDIC and FSLIC, under Gramm-Rudman. Although the act exempts prior legal obligations, Congress clearly intended to impose spending reductions, beyond administrative expenses, on these programs.

1. CBO and OMB estimated an $8 million reduction for the Federal Deposit Insurance Corporation. Does this represent a reduction in total spending authority (other than prior legal obligations) or is it based on more narrowly defined administrative expenses?

2. CBO and OMB estimated a $1 million cut for the Federal Home Loan Bank Board and the Federal Savings and Loan Insurance Corporation, which I understand is based on a limit on administrative expenses already enacted. Why is the reduction for FSLIC and the Bank Board based on this obligation limit alone and not on total spending? Is this consistent with the treatment of FDIC?

3. In the case of these insurance funds, how have you defined "prior legal obligations"? Does it include only payment of insurance claims or have you defined the term more broadly to include other operations of these agencies?

Answer

Prior legal obligations were defined to encompass all activities of the agencies associated with financial institutions that have already failed, as well as loans, cash contributions, and other activities aimed at avoiding failures of problem institutions. Once an institution is federally insured (even if it becomes insured after the "snapshot" date), it is considered a prior legal obligation.

All expenses of the thrift insurance agencies--FDIC, FSLIC, Federal Home Loan Bank Board, National Credit Union share insurance--and of the Comptroller of the Currency were considered sequesterable, except for those resulting from prior legal obligations. (Some errors in this regard in our report were corrected in the GAO report.) Such expenses were represented by the limitation on administrative expenses of the FSLIC and the Federal Home Loan Bank Board, and by estimates of the corresponding expenses of the other agencies.

Government Payment for Annuitants, Employees Health Benefits

Questions

My question concerns the funds appropriated to cover the federal government's share of retired federal employee's health benefits. As you know, this is a separate account, amounting to $1.6 billion in FY 1986. These funds are appropriated into the Employee's Health Benefits Fund, a revolving fund in OPM used to pay employee health insurance premiums for all federal employees and annuitants.

1. This appropriation, therefore, is an intragovernmental transfer used to pay a legally binding obligation of the federal government to its employees and retirees. As such, can you explain why this account was sequestered?

2. Do you believe that, in keeping with the general policy of exempting intragovernmental transfers, this account should have been exempted?

3. I would appreciate it if you could provide the Committee with information on whether this reduction will affect the payment of the federal share of annuitant health insurance and whether there will be an increase in an annuitant's premium?

Answer

These payments were not excluded from sequester by the Balanced Budget Act. The government payment for annuitants is an appropriated account and is not an "intragovernmental fund."

On the other hand, the Act specifically excludes from sequester a number of appropriated accounts that make payments to other funds. If the intent is not to reduce the government subsidy for annuitant's health insurance, this account should have been included on the list of exempt accounts.

The sequestered amount of the government payment for annuitants in 1986 should not result in either an increase in annuitant's premiums or a reduction in benefits. Unobligated balances carried forward from 1985 are sufficient to avoid any 1986 reductions.

In 1987 and beyond, the Office of Personnel Management could reduce benefits if required by the sequestration of funds. The annuitant's share of premiums could not be increased without legislation.

Treatment of Spending Related to Certain Offsetting Collections

I understand that questions have been raised about sequestering certain types of federal spending that represent work done for the public for which the public reimburses the federal government.

A good example of this would be where a NASA space shuttle launches a telecommunications satellite for a private communications firm. Another example would be where the Department of Energy enriches uranium for a private utility. In these cases, the private entity pays the government for the services rendered and those payments are available for use by the federal agency performing the work. There are, of course, other examples that might be cited.

As I understand it, both the CBO/OMB report and the GAO report assume that federal spending for such purposes is sequesterable. I understand that OMB and CBO differed on this issue and submitted the question to GAO at an early stage so that a single approach could be reflected in their joint report. Therefore, I assume our three witnesses are very familiar with this issue. I have several questions.

Question

What is the approximate total size of spending of this kind that has been included in the sequesterable base and what is the amount proposed for sequester?

Answer

Approximately $1.3 billion in budgetary resources was involved in the issue of offsetting collections from nonfederal sources. A 4.3 percent sequester would reduce this amount by $58 million.

Question

Is it possible to maintain the pre-sequester level of payments from the public for these services if the federal spending for them is reduced by a sequester order? Are there any differences in this regard among the various activities involved?

Answer

It is likely that the 4.3 percent sequester for 1986 will not materially affect the level of payments from the public. Sequesters of larger amounts, however, or continued reductions in federal program levels, presumably would lead to lower payments from the public.

Question

If payments from the public for these services are reduced by an amount approximately equal to the sequester reduction, what is the effect on the deficit?

Answer

It would offset the reduction in federal spending, so that no deficit reductions would be made.

Question

Can you furnish the Committee a list of the activities of this kind that you have included in your sequester base, together with the amount of sequester proposed in each case and your judgment in each instance as to (a) whether the level of collections from the public would have to be reduced in line with the sequester cut, or (b) whether the collections could be maintained at pre-sequester levels even in the face of a sequester cut.

Answer

A list of budget accounts and the amount of sequesterable spending financed by offsetting collections from your federal sources is attached. It is likely that no reductions in collections from the public will result from the 4.3 percent sequester in 1986.

Question

Are there instances where Federal law requires a level of service for which the public pays that would be difficult to maintain in the face of a sequester order? (e.g., meat and poultry inspection)

Answer

Not that we are aware of for FY 1986.

Question

Based on the analysis you have done, do you have any recommendations on how we should treat spending of this kind?

Answer

We are not aware that the conferees on H.J. Res. 372 specifically considered the issue of whether federal spending that is financed by offsetting collections from the public should be subject to sequester. It could be argued that spending financed by such collections are not part of the deficit problem and, therefore, should not be sequestered. On the other hand, it could be argued that all federal spending, regardless of how it is financed, should be subject to sequester. This is a matter for the Congress to decide.

Sequesterable Outlays from Offsetting Collections From Nonfederal Sources, Fiscal Year 1986 (in thousands of dollars)

Budget Account	Amount
Legislative Branch	
Library of Congress Salaries and expenses (01-25-0101 -X-1-503-A; 03-0101)	4,128
Funds Appropriated to the President	
Peace Corps operating expenses (04-18-0100 -X-1-151-A; 11-0100)	500
Inter-American Foundation (04-22-4031 -X-3-151-A; 11-4031)	16,000
Department of Agriculture	
Agricultural Research Service (05-18-1400 -X-1-352-A; 12-1400)	2,000
Extension Service (05-27-0502 -X-1-352-A; 12-0502)	625
Statistical Reporting Service Salaries and expenses (05-33-1801 -X-1-352-A; 12-1801)	1,060
Office of International Cooperation & Development Salaries and expenses (05-53-3200 -X-1-352-A; 12-3200)	665
Agricultural Stabilization & Conservation Service Salaries and expenses (05-60-3300 -X-1-351-A; 12-3300)	34,266
Farmers Home Administration Rural development insurance fund (05-75-4155 -X-3-452-A; 12-4155)	412
Soil Conservation Service Conservation Operations (05-78-1000 -X-1-302-A; 12-100)	13,927
Resource conservation and development (05-78-1010 -X-1-302-A; 12-1010)	1,983
Watershed planning (05-78-1066 -X-1-301-A; 12-1066)	750

Budget Account	Amount
River basin surveys and investigations (05-78-1069 -X-1-301-A; 12-1069)	328
Watershed and flood prevention operations (05-78-1072 -X-1-301-A; 12-1072)	8,020
Animal and Plant Health Inspection Service Salaries and expenses (05-79-1600 -X-1-352-A; 12-1600)	8,860
Federal Grain Inspection Service Inspection and weighing services (05-80-4050 -X-3-352-A; 12-4050)	36,856
Agricultural Marketing Service Marketing services (05-81-2500 -X-1-352-A; 12-2500)	28,450
Milk market orders assessment fund (05-81-8412 -X-8-351-A; 12-8412)	33,610
Food Safety and Inspection Service Salaries and expenses (05-83-3700 -X-1-554-A; 12-3700)	39,100
Forest Service Construction (05-96-1103 -X-1-302-A; 12-1103)	2,110
Forest research (05-96-1104 -X-1-302-A; 12-1104)	496
State and private forestry (05-96-1105 -X-1-302-A; 12-1105)	228
Forest Service permanent appropriations (05-96-9922 -X-2-302-A; 12-9922)	4
Department of Agriculture Agency Total	213,750

Budget Account	Amount
Department of Commerce	
Bureau of the Census Salaries and expenses (06-07-0401 -X-1-376-A; 13-0401)	12,000
Economic and Statistical Analysis Salaries and expenses (06-08-1500 -X-1-376-A; 13-1500)	382
International Trade Administration Operations and administration (06-25-1250 -X-1-376-A; 13-1250)	9,242
United States Travel and Tourism Administration Salaries and expenses (06-44-0700 -X-1-376-A; 13-0700)	935
National Oceanic and Atmospheric Administration Operations, research, and facilities (06-48-1450 -X-1-306-A; 13-1450)	11,213
Coastal energy impact fund (06-48-4315 -X-3-452-A; 13-4315)	8,000
Patent and Trademark Office Salaries and expenses (06-51-1006 -X-1-376-A; 13-1006)	119,486
Department of Commerce Agency Total	161,258
Department of Defense--Civil	
Corps of Engineers--Civil Flood control, Mississippi River and tributaries (08-10-3112 -X-1-301-A: 96-3112)	400
General investigations (08-10-3121 -X-1-301-A; 96-3121)	60
Construction, general (08-10-3122 -X-1-301-A; 96-3122)	723
Operation and maintenance, general (08-10-3123 -X-1-301-A; 96-3123)	5,833

Budget Account	Amount
Soldiers' and Airmen's Home Operation and maintenance (08-20-8931 -X-7-705-A; 84-8931)	144
Department of Defense--Civil Agency Total	7,160
Department of Health and Human Services	
Food and Drug Administration Revolving fund for certification end other services (09-10-4309 -X-3-554-A; 75-4309)	2,624
Health Resources and Services Health resources and services (health care services) (09-15-0350 -X-1-551-A: 75-0350)	150
Centers for Disease Control Disease control (Health care services) (09-20-0943 -X-1-551-A; 75-0943)	1,100
National Institutes of Health National Cancer Institute (Health research) (09-25-0849 -X-1-552-A: 75-0849)	10
National Institute of Neurological & Communicative Disorders (09-25-0886 -X-1-552-A; 75-0886)	12
Alcohol, Drug Abuse, & Mental Health Administration Federal subsidy for St. Elizabeths Hospital (09-30-1300 -X-1-551-A; 75-1300)	42,827
Office of Assistant Secretary for Health Public health service management (Health care services) (09-37-1101 -X-1-551-A; 75-1101)	310
Social Security Administration Assistance payments program (09-60-0412 -X-1-609-A; 75-0412)	103
Child support enforcement (09-60-0430 -X-1-609-A; 75-0430)	61
Department of Health and Human Services Agency Total	47,197
Department of Housing and Urban Development	
Housing Programs Rental housing assistance fund (25-02-4041 -X-3-604-A; 86-4041)	2,500

Budget Account	Amount
Department of the Interior	
Bureau of Land Management Management of lands and resources (10-04-1109 -X-1-302-A; 14-1109)	4,000
Bureau of Reclamation Construction program (10-10-0684 -X-1-301-A; 14-0684)	110
Lower Colorado River basin development fund (10-10-4079 -X-3-301-A; 14-4079)	100,290
Upper Colorado River basin fund (10-10-4081 -X-3-301-A; 14-4081)	28,799
General investigations (10-10-5060 -X-2-301-A; 14-5060)	80
Operation and maintenance (10-10-5064 -X-2-301-A; 14-5064)	11,173
Geological Survey Surveys, investigations and research (10-12-0804 -X-1-306-A; 14-0804)	82,385
Bureau of Mines Helium fund (10-14-4053 -X-3-306-A; 14-4053)	1,600
United States Fish and Wildlife Service Resource management (10-18-1611 -X-1-303-A; 14-1611)	4,475
National Park Service Operation of the national park system (10-24-1036 -X-1-303-A; 14-1036)	3,500
Construction (10-24-1039 -X-1-303-A; 14-1039)	8,600
Bureau of Indian Affairs Operation of Indian programs (Area and regional development) (10-76-2100 -X-1-452-A; 14-2100)	1,000
Road construction (10-76-2364 -X-1-452-A; 14-2364)	1,000
Department of the Interior Agency Total	247,012

Budget Account	Amount
Department of Justice	
Legal Activities Fees and expenses of witnesses (11-05-0311 -X-1-752-A; 15-0311)	50
Salaries and expenses, United States Marshals Service (11-05-0324 -X-1-752-A; 15-0324)	577
Federal Bureau of Investigation Salaries and expenses (11-10-0200 -X-1-751-A; 15-0200)	11,790
Drug Enforcement Administration Salaries and expenses (11-12-1100 -X-1-751-A; 15-1100)	850
Immigration and Naturalization Service Salaries and expenses (11-15-1217 -X-1-751-A; 15-1217)	14,354
Federal Prison System Salaries and expenses (11-20-1060 -X-1-753-A; 15-1060)	9,465
Department of Justice Agency Total	37,086
Department of State	
Administration of Foreign Affairs Acquisition and maintenance of buildings abroad (14-05-0535 -X-1-153-A; 19-0535)	7,500
International Organizations and Conferences Contributions to international organizations (14-10-1126 -X-1-153-A; 19-1126)	3,886
Department of State Agency Total	11,386
Department of Transportation	
Saint Lawrence Seaway Development Corporation (21-40-4089 -X-3-403-A; 69-4089)	13,000

Budget Account	Amount
Department of the Treasury	
United States Customs Service Salaries and expenses (15-15-0602 -X-1-751-A; 20-0602)	67,705
Bureau of the Mint Salaries and expenses (15-25-1616 -X-1-803-A; 20-1616)	100,691
Department of the Treasury Agency Total	168,396
Environmental Protection Agency Salaries and expenses (20-00-0200 -X-1-304-A; 68-0200)	800
Revolving fund for certification and other services (20-00-4311 -X-3-304-A; 68-4311)	650
Hazardous substance response trust fund (20-00-8145 -X-7-304-A; 20-8145)	9,261
Environmental Protection Agency Agency Total	10,711
National Aeronautics and Space Administration Research and program management (26-00-0103 -X-1-250-A; 80-0103)	14,000
Space Flight, Control, and Data Comm. (26-00-0105 -X-1-250-A; 80-0105)	127,300
Research and development (26-00-0108 -X-1-250-A; 80-0108))	40,694
National Aeronautics and Space Administration Agency Total	181,994
Office of Personnel Management Revolving fund (27-00-4571 -X-4-805-A; 24-4571)	1,378

Budget Account	Amount
Veterans Administration	
Canteen service revolving fund (29-00-4014 -X-3-705-A; 36-4014)	188,461
Special therapeutic and rehabilitation activities fund (29-00-4048 -X-3-703-A; 36-4048)	2,325
Veterans Administration Agency Total	190,786
Other Independent Agencies	
National Archives and Records Administration National archives trust fund (31-26-8436 -X-8-804-A; 88-8436)	7,675
Pennsylvania Avenue Development Corporation Land acquisition and development fund (32-08-4084 -X-3-451-A; 42-4084)	25,000
Other Independent Agencies Agency Total	32,675
TOTAL	1,346,917

WRITTEN COMMITTEE QUESTIONS TO COMPTROLLER GENERAL BOWSHER AND THE RESPONSES

ACCOUNTS WITH NO OUTLAY REDUCTION

The report to GAO notes that in a few instances, the uniform percentage reduction of budgetary resources would not produce any outlay savings this year or in any future years.

Question

1. Would you please explain this problem further and cite some of the major examples?

Answer

1. The application of a uniform percentage sequester to budgetary resources does not immediately reduce outlays in some accounts. These are accounts with large prior year unexpended balances, low outlay rates from new resources, or more new resources than they can use. In most cases, however, there would be outlay reductions resulting from the sequester in subsequent years.

   Also, accounts whose budgetary resources are authorized loan guarantee levels, or which have more resources than they can use, could experience a sequester in those resources with little or no projected effect on outlays even in future years.

   The number of non-defense accounts in the OMB/CBO report with sequestered budgetary resources but no reported outlay cut for fiscal year 1986 are relatively few--15 in all.

   The largest ones are:

   --HUD's, "Payments for Operation of Low Income Housing Projects" (86-0163-0-1-604), budget authority sequester of $52.1 million.

   --Funds to the President, "Multilateral Assistance Contribution to the International Development Association " (11-0073-0-1-151), budget authority sequester of $30.1 million.

   --Funds to the President, "Contribution to the African Development Fund" (11-0079-0-1-151), budget authority sequester of $2.7 million.

Question

2. Do you believe that it is consistent with Congressional intent that these programs be spared any outlay reduction in FY 1986?

Answer

2. The Balanced Budget and Emergency Deficit Control Act of 1985 establishes a process for eliminating annual budget deficits over the next five years. The statute contemplates doing this by applying uniform percentage reductions to sequesterable budgetary resources. The sequesters for fiscal year 1986 are intended to achieve the required overall reductions in outlays for that year. As discussed above, this will not result in an immediate outlay reduction in some individual accounts. In most of these accounts, this year's sequester will result in outlay reductions in future years.

Question

3. In the future, how might we insure that outlays for all programs be reduced by a uniform percentage, unless specifically exempted?

Answer

3. Under the Act, budget resources, not outlays, are subject to the uniform percentage sequesters. The Act could be amended to require uniform reductions on outlays. However, this would result in a major change in the conceptual basis of the statute.

CONTRIBUTED FUNDS EXEMPTION

Question

1. I understand that in defining the budgetary base for the sequester order, CBO and OMB exempted spending from contributed funds. I am told, for example, that spending in the "Rivers and Harbors Contributed Funds" account, which is funded from voluntary contributions from localities towards the financing of Corps of Engineers' water projects, was fully exempted in your report. Please explain your rationale for exempting this account.

Answer

1. Section 255(g)(1) of the Act specifically exempts from reduction activities resulting from private donations, bequests, or "voluntary contributions." OMB and CBO considered this account to fall within the latter category, and we had no reason to disagree with that determination.

Question

2. How much of the budgetary resource base did you exempt as contributed funds?

Answer

2. Neither the OMB/CBO report nor backup material provided to GAO systematically identified the specific amount of budgetary resources considered to be exempt under the voluntary contributions exemption.

Question

3. An analogous situation to the Corps of Engineers contributed funds arises in NASA's Shuttle account where private companies pay costs associated with launching satellites. I understand that CBO and OMB did not exempt spending related to these contributions. Please explain your rationale for not exempting this account, particularly in light of the Corps' exemption.

Answer

3. The Space Shuttle operations program provides launch services for domestic, commerical missions on a reimbursable basis. Such reimbursements are treated in the budget as offsetting collections from non-federal sources credited to the NASA Space Flight, Control and Data Communications account. In contrast, non-federal cash contributions to authorized federal rivers and harbors projects are treated in the budget as "contributed funds," made available for expenditure under permanent indefinite appropriations. The application of Public Law 99-177 to the accounts, both by the OMB/CBO report and by GAO, was consistent with this budgetary treatment.

GOVERNMENT PAYMENT FOR ANNUITANTS, EMPLOYEES HEALTH BENEFITS

My question concerns the funds appropriated to cover the federal government's share of retired federal employee's health benefits. As you know, this is a separate account, amounting to $1.6 billion in FY 1986. These funds are appropriated into the Employee's Health Benefits Fund, a revolving fund in OPM used to pay employee health insurance premiums for all federal employees and annuitants.

Question

1. This appropriation, therefore, is an intragovernmental transfer used to pay a legally binding obligation of the federal government to its employees and retirees. As such, can you explain why this account was sequestered?

Answer

1. The OPM budget account "Government Payment for Annuitants, Employees Health Benefits" (24-0206-0-1-551) is not, itself, an intragovernmental fund--i.e., it is not an account that is funded by transfers of funds from other budget accounts. It is funded annually by its own appropriation of monies from the Treasury's general fund. It therefore does not qualify as an exempt intragovernmental fund. Sequestration of its budgetary resources does not involve a "double hit," as would be the case in sequestering the federal funds of an intragovernmental fund.

Question

2. Do you believe that, in keeping with the general policy of exempting intragovernmental transfers, this account should have been exempted?

Answer

2. Perhaps this account should have been exempted, but not because of the general policy of exempting intragovernmental funds. This is not an intragovernmental fund. The Congress may have inadvertantly omitted the account from the list of exempt accounts and activities in section 255(g)(1) of Public Law 99-177. Other accounts with similar activities--for example, OPM's "Payment to Civil Service Retirement and Disability Fund"--were placed on the exempt list.

Question

3. I would appreciate it if you could provide the Committee with information on whether this reduction will affect the payment of the federal share of annuitant health insurance and whether there will be an increase in an annuitant's premium?

Answer

3. Whether the federal government can absorb this sequester and sustain its share of annuitant health insurance depends upon the size of the existing reserves held by the insurance carriers and by the federal government in its "Employees Health Benefits Fund" (24-8440-0-8-551), and the availability of those reserves for offsetting the sequester.

INSURANCE FUNDS

Some people have raised questions about the treatment of insurance funds, like FDIC and FSLIC, under Gramm-Rudman. Although the act exempts prior legal obligations, Congress clearly intended to impose spending reductions, beyond administrative expenses, on these programs.

Question

1. CBO and OMB estimated an $8 million reduction for the Federal Deposit Insurance Corporation. Does this represent a reduction in total spending authority (other than prior legal obligations) or is it based on more narrowly defined administrative expenses?

Answer

1. The OMB/CBO reduction was a reduction in total spending authority for other than prior legal obligations. In its actions on the OMB/CBO report, GAO added $351 thousand to the sequester for the Federal Deposit Insurance Corporation (FDIC). GAO's report stated, "Our revision adds administrative amounts funded by offsetting collections from non-federal sources."

Question

2. CBO and OMB estimated a $1 million cut for the Federal Home Loan Bank Board and the Federal Savings and Loan Insurance Corporation, which I understand is based on a limit on administrative expenses already enacted. Why is the reduction for FSLIC and the Bank Board based on this obligation limit alone and not on total spending? Is this consistent with the treatment of FDIC?

Answer

2. Unlike FDIC, the Federal Savings and Loan Insurance Corporation (FSLIC), operates under an annual appropriation act limitation on administrative expenses. OMB and CBO used this limitation for fiscal year 1986 as the sequesterable base of FSLIC. GAO did not change the amount.

   Concerning the Federal Home Loan Bank Board, OMB and CBO used the appropriation act limitation on the Board's fiscal year 1986 administrative expenses as the sequesterable base. This meant that the Board's entire, on-budget resources were included in the base and subject to a sequester. GAO did not change this treatment.

Question

3. In the case of these insurance funds, how have you defined "prior legal obligations?" Does it include only payment of insurance claims or have you defined the term more broadly to include other operations of these agencies?

Answer

3. GAO did not interpret "prior legal obligations" narrowly to include only the payment of insurance claims. The same approach was followed by OMB and CBO. A narrow approach could run the risk of sequestering amounts that are so closely tied to prior legal obligations as to involve a sequester, in practical effect, upon those obligations. We elected to follow a prudent course to protect the integrity of these insurance activities.

   We intend to study our treatment of FDIC and FSLIC in consultation with OMB and CBO in order to insure consistent and proper treatment of these accounts in the event that there is another sequester order under the Act.

TREATMENT OF SPENDING RELATED TO CERTAIN OFFSETTING COLLECTIONS

I understand that questions have been raised about sequestering certain types of federal spending that represent work done for the public for which the public reimburses the federal government.

A good example of this would be where a NASA space shuttle launches a telecommunications satellite for a private communications firm. Another example would be where the Department of Energy enriches uranium for a private utility. In these cases, the private entity pays the government for the services rendered and those payments are available for use by the federal agency performing the work. There are, of course, other examples that might be cited.

As I understand it, both the CBO/OMB report and the GAO report assume that federal spending for such purposes is sequesterable. I understand that OMB and CBO differed on this issue and submitted the question to GAO at an early stage so that a single approach could be reflected in their joint report. Therefore, I assume our three witnesses are very familiar with this issue. I have several questions.

Question

1. What is the approximate total size of spending of this kind that has been included in the sequesterable base and what is the amount proposed for sequester?

Answer

1. The OMB/CBO report identified $1,434,432,000 (average of OMB and CBO amounts) in total spending of this kind as in the sequesterable base, entailing a sequester of $61,681,000. GAO added another $60,367,000 in offsetting collections spending to the base, entailing added sequesters totaling $2,596,000.

Question

2. Is it possible to maintain the pre-sequester level of payments from the public for these services if the federal spending for them is reduced by a sequester order? Are there any differences in this regard among the various activities involved?

Answer

2. There are differences in this regard among various activities. In some federal programs that receive offsetting collections, the collections levels are not dependent, at least in any direct way, upon a level of

federal spending. Collections from users of federal land is an example. Cuts in spending would not likely result in reduced collections.

In other cases, there is a closer relationship between the level of spending and reimbursable collections. The meat and poultry inspection reimbursable program of the Department of Agriculture is an example. There, the level of collections received is a direct function of the number of special inspections performed by federal employees. Fewer inspections would mean fewer collections. However, even in such a case, a sequester applied against the relevant budget account would not necessarily result in fewer inspections and fewer collections. It might be possible to absorb the reduction in resources through improved efficiency of operations or reductions in non-reimbursable activities.

Question

3. If payments from the public for these services are reduced by an amount approximately equal to the sequester reduction, what is the effect on the deficit?

Answer

3. There would be no effect on the deficit. However, as discussed above, it would be possible in many cases to absorb the spending cuts in a manner that does not cause a reduction in collections. In such cases, the effect would be to reduce the deficit.

Question

4. Can you furnish the Committee a list of the activities of this kind that you have included in your sequester base, together with the amount of sequester proposed in each case and your judgment in each instance as to (a) whether the level of collections from the public would have to be reduced in line with the sequester cut, or (b) whether the collections could be maintained at pre-sequester levels even in the face of a sequester cut.

Answer

4. Additional time and research would be required to identify and analyze accounts where reduced spending would result in reduced collections of approximately equal size.

Question

5. Are there instances where federal law requires a level of service for which the public pays that would be difficult to maintain in the face of a sequester order? (e.g., meat and poultry inspection)

Answer

5. Further analysis would be required to assess the impact of sequesters upon levels of service provided the public.

Question

6. Based on the analysis you have done, do you have any recommendations on how we should treat spending of this kind?

Answer

6. Not at this time. The reimbursable activities of the federal government are quite varied, and involve a wide spectrum of legal and financial arrangements. Any recommendations should be based upon a careful study of these programs.

[From the Washington Post, Jan. 21, 1986]

THE GHOSTS OF DEFICIT FOREVER

THE SENATE BUDGET COMMITTEE CHAIRMAN SPINS A DICKENSIAN TALE FOR THE RETURNING CONGRESS

(By Pete V. Domenici)

In less than three weeks the automatic spending cuts of Gramm-Rudman-Hollings will be triggered unless a court challenge to the new law succeeds. The papers will be filled with the confusion of federal agencies trying to fulfill the law and the outrage of those program beneficiaries who see their activities threatened. Before the coming public panic consumes us, we should review where we are, how we got here, and where we are likely to end up in our struggle with the deficit.

As a prelude, I should note that I am extremely optimistic about the nation's economic potential. We have solved problems of the highest order. We have created millions of jobs for "Baby Boom" workers. We have embarked on a new era of entrepreneurship and rising per-capita incomes. A leanness and quickness characterizes the private sector.

The only cloud on the horizon, and a cloud of mammoth proportions in my view, is the inability of the government to control deficits. The extraordinary deficits we now face symbolize this impotence and also hold the substantive prospect of plunging the nation into an unprecedented economic recession—ironically, one that could well be avoided. The deficit, simply put, remains the foremost policy and political problem confronting the nation. If I may borrow from Dickens, I will call upon three ghosts to lead us on our budget odyssey: the ghosts of budget past, present and yet to come.

1. BUDGETS PAST

Our Ghost of Budgets Past conjures up a scene of candidate Ronald Reagan speaking in Chicago in September 1980. He explains in some detail his four-part plan for the economy and the federal budget: 1) a 10 percent across-the-board tax cut for individuals in each of the next three years to increase take-home pay and the dismal national savings rate; 2) major changes in the corporate tax code aimed at reviving the staggering American economy; 3) an all-out attack on waste, fraud and abuse in government spending, coupled with a permanent shrinking of the government's programs, directed at saving tens of billions of dollars a year; and 4) a major increase in defense spending.

The president-to-be calmly explains that the increase in defense spending will be "affordable," because his other policies will yield a combination of new revenues to the government (from economic growth) and less domestic spending (from a shrinking of federal domestic programs).

Our ghost next takes us to March 10, 1981. The president releases the details of his 1982 budget, which replaces the budget of former president Jimmy Carter. The budget is truly revolutionary. It calls for domestic spending cuts in fiscal year 1982 alone of $67 billion. Between FY 1981 and FY 1986, the domestic cuts would total $475 billion.

On top of unprecedented domestic spending restraint, the president fulfills his second major campaign promise by requesting the largest single defense increase in the nation's history. For FY 1982, this increase would reach nearly $29 billion and would push defense spending from the FY 1980 level of $146 billion to $226 billion in just two years—an increase of 55 percent.

The budget also keeps the president's promise on taxes. It requests individual and corporate tax cuts of $54 billion in FY 1982 and $718 billion through FY 1986.

Above all, our ghost points to the line in the president's budget that shows that if all his policies were fully implemented, the federal budget would be balanced by FY 1984 and would be running a $28 billion surplus by 1986.

Two major points overlooked by many in that first, fateful budget will come back to haunt the nation. First, almost $75 billion in domestic cuts necessary for achieving a balanced budget in 1984 are not itemized and "will be identified later." Second, the economic projections underlying the budget assume real growth in the economy almost double the historical average for the past 12 years (4.6 percent projected compared to 2.5 percent actual for the 1972–84 time frame).

Finally, our Ghost of Budgets Past takes us to the private conference room of the Senate majority leader, Howard Baker, in early spring of 1981. In the room for an extraordinary meeting is the president, who has left the White House and journeyed to the Hill. The president leans across the table and tells the 12 Republican members of the Senate Budget Committee that he will not support a bipartisan attempt in that committee to freeze cost-of-living adjustments for Social Security recipients as part of a deficit-reduction plan. He asks them to join his opposing effort. In front of the senators is a sheet showing savings from a one-year freeze on the COLAs—$88 billion over five years, and more than $24 billion in the year 1986 alone.

The senators relent. They go back to committee and vote against the move to freeze COLAs. Social Security, although larger than all domestic non-entitlement spending programs put together, is protected in future budget battles; it comprises almost 25 percent of the non-interest spending in the federal budget.

2. BUDGETS PRESENT

Our Ghost of Budgets Present arrives, looking weary and battered. He has watched three years of congressional deadlock; the deficits for the first four years of the Reagan administration have amounted to more than all the deficits accumulated by all other presidents in the nation's lifetime. America is amassing debt—corporate, individuals and governmental—at a record pace.

Yet, no perceptible crisis is at hand. Unemployment has subsided below the 7 percent mark; inflation and interest rates are down and dropping further; the economy is perking along at about the historical average growth: 2.5 to 3 percent annually. Everyone thinks the deficit may be a problem, but the political will to tackle it head-on is fading. The short-term pain of policies that would really cut deficits overwhelms the short-term gain of voting to retain Congress' favorite programs.

Our Ghost of Budgets Present reveals an internal congressional staff memo showing that despite public displays of budget-cutting enthusiasm, Congress has allowed large spending increases since FY 1980: an increase of $132 billion (99 percent) in national defense; $169 billion in new spending for domestic entitlement programs (an increase of 60 percent), driven by new Social Security increases; and an additional $26 billion in domestic, discretionary spending (a 17 percent hike).

It turns out that many of the "cuts" were measured from baselines that assumed growth, so even with a cut there was frequently an actual increase in dollars. The memo also shows that revenues have dropped off from those original FY 1982 presidential projections by about $150 billion in FY 1986. Moreover, the gross national product forecast by that FY 1982 budget fell short of reality by $2.4 trillion for FY 1982-86. Almost nothing is "affordable" any more, in the sense that word was used way back in September 1980.

Even worse, the restraint in spending that has occurred has spared programs that stress present consumption (pensions are a prime example) and hampered programs that stress investment in the future (research in nondefense scientific areas, basic physical infrastructure, education).

Interest payments on this debt are $200 billion annually and are the fastest growing element of federal spending. This means that America cannot make the basic commitment to the future that needs to be made in order to ensure the unparalleled prosperity to which all other indicators point.

We now move to February 1985. The president has emerged from his reelection campaign with one of the most overwhelming victories in America's history. Undeterred deficit-fighters in the administration and in Congress conspire to make one last fight to get deficits under control.

The president's budget asks once again for large domestic spending cuts, $180 billion over three years, with the elimination of more than a dozen major domestic programs as the centerpiece of the plan. The budget also asks for a $30 billion increase in defense spending for FY 1986 alone, and rejects tax increases. It projects a deficit of $144 billion in FY 1988, twice as high as any deficit in the non-Reagan era, but a substantial move toward what economists are now calling "structural budget balance."

The ghost now takes us to a dramatic moment. It is May 9, well past midnight. The Senate has concluded debate on an unprecedented deficit reduction package, incorporating Social Security COLA freezes and eliminating several programs. It not only will meet the president's deficit reduction goal in FY 1986, it will yield substantially lower deficits by FY 1988.

The vote now stands at 49-48 against the proposal. Sen. Pete Wilson of California arrives from a hospital, where he underwent emergency appendectomy surgery earlier. Against doctor's recommendations, he has come to the Senate in a wheelchair, an intravenous tube in his arm, to vote. He votes for the proposal. With the vote 49-49, Vice President George Bush, in his capacity as president of the Senate, votes for it. It passes, 50-49.

Although only a few suspect it at the time, that moment in the Senate chamber will be the high point for deficit cutting for the year. Our Ghost of Budgets Present speeds over a troubled summer. The budget finally hammered out between House and Senate falls short of the Senate-passed version, in large part because the president finally opposes any change in Social Security COLAs. His decision dooms any significant congressional action.

Congress finds it impossible to pass almost any significant bills. Appropriations bills fail to move. Approaching is an autumn vote to extend the federal debt the government has run up. Sens. Gramm, Rudman and Hollings conceive a new deficit-cutting mechanism and attach it to the debt limit bill.

Our ghost now takes us to December 1985. Congress sends the president a farm bill that costs an estimated $50 billion during the next three years, about double what the president requested in his FY 1986 budget of nine months earlier. Congress finds it difficult to comply with even the watered-down budget it passed just four months earlier. Congress staggers through a chaos of short-term continuing appropriations and short-term debt extensions, all of which threaten to shut down the government.

Finally, Congress passes more spending bills, postpones action on a multibillion-dollar deficit reduction measure that the administration threatens to veto, and heads home. The president signs the farm bill into law. He signs all of the spending bills, even though they contain in the aggregate about $40 billion more in domestic spending than he wanted and about $30 billion less for defense. He signs the Gramm-Rudman-Hollings bill.

Within a fortnight, the Justice Department announces that it will join in attacking the constitutionality of Gramm-Rudman-Hollings. The president asks for $4 billion more spending for the Commodity Credit Corporation, sending up his formal request Dec. 23. A year that began with high hopes for deficit reduction fizzles into the winter rain of utter failure. Our Ghost of Budgets Present decides to become a consultant to corporations on the impact of Gramm-Rudman-Hollings.

3. BUDGETS YET TO COME

Our Ghost of Budgets Yet to Come offers us a choice. First he takes us to February 1986. The president and Congress have been given the size of the automatic cut order (called a sequester order) mandated by the Gramm-Rudman-Hollings bill for FY 1986. It will take a total of $11.7 billion from federal outlays, equally split between defense and nondefense programs.

This leaves defense spending in March 1986 about $40 billion less than the president's original request for the year. Nondefense programs will be cut in some cases below last year's level. Senators up for reelection later in the year are besieged by interest groups hit by the sequester.

Yet, this tiny cut pales in comparison to what may be necessary later in the year. Our ghost reveals internal staff documents that show deficits of more than $205 billion in FY 1987, a full $60 billion over the Gramm-Rudman-Hollings target of $144 billion. The president presents his budget in early February. It contains a request for $20 billion more in defense spending. It terminates scores of federal programs through direct cuts and privatization ideas. It rejects new taxes. It is kept alive by Congress mostly as a vehicle for repudiation.

Here our ghost presents two scenarios. Sadly, one is more likely than the other. The first scenario is the hope of many of us who voted for Gramm-Rudman-Hollings—a comprehensive compromise on the deficit. It goes like this:

1) Late March 1986: the president and Congress, unable to come up with a budget for the 1987 year, agree to a "Grand Summit" on the budget. Tax reform plans in the Senate are temporarily laid aside in order to focus on deficit reduction.

2) April 1986: After weeks of negotiations, Congress and the president agree on a historic deficit-cutting package, including fundamental reforms and reductions in domestic spending, a slowing of the defense buildup, and new revenues.

3) May and June 1986: Congress passes new laws implementing the "summit" agreement and appropriations bills that are consistent with it.

4) August 1986: Congressional Budget Office and the Office of Management and Budget compare their spending updates and conclude that because of presidential and congressional action, the deficit targets of Gramm-Rudman-Hollings will indeed be met.

5) The stock market surges, interest rates drop, and the economy takes off. America soars into the future.

But that scenario may be unlikely for many reasons, so our ghost provides a second scenario feared by many of us who are familiar with the realities of both the budget and of the politics of 1986:

1) Late March 1986: The president's budget has been rejected in all quarters. Congress tries to devise its own budget and fails. The president vigorously pursues his tax reform plan in the Senate, opposing any tax increase within the plan.

2) April and May 1986: the Senate, with 30 members watching primary results that will select their opponents in the November elections, is stymied. Tax reform is stalled, the budget cannot move, and appropriations bills await some resolution of the deadlock. The House puts off action, claiming it cannot act until some initiative is taken by either the president or the Senate.

3) June 1986: The supreme court rules Gramm-Rudman-Hollings constitutional.

4) Summer 1986: As the stock and bond market and most of the rest of the world watch, America's government is nearly paralyzed. The size of the amounts needed to meet the $144 billion deficit target prohibit action: $30 billion from defense and from nondefense spending translate into as much as $75 billion in budget authority from defense spending (or almost one-fourth of all new spending authority for defense) and about $45 billion from nondefense programs (or about one-third of all new budget authority in the appropriated, discretionary accounts).

5) September 1986: Gramm-Rudman-Hollings in the amount of a $60 billion sequester goes into effect, causing grave concern among America's Western Allies. Most Senate campaigns are now in the post-Labor Day "hot" period. Groups that participate in federal domestic programs, especially teachers and health professionals, descend on Washington in huge numbers. Many state governments begin to lay off large numbers of employees to try to compensate for cuts in state and local aid.

6) October 1986: One month before the 1986 federal elections, the president decides that his position as commander-in-chief compels him not to sign the final sequester order because it would violate his oath of office to defend the nation's security. Already more than 100 lawsuits have been filed against the Gramm-Rudman-Hollings cuts by potential program beneficiaries.

7) Mid-October 1986: Congress, faced with an unprecedented uproar, coupled with the plummeting stock and bond market, tries to devise a way to cope with the new crisis. Everyone attempts to find a way to get out from under the new law. Someone suggests that we need a budget forecast that shows a recession sometime in the next four quarters. The person who makes the suggestion is widely applauded as a genius, and soon the Gramm-Rudman-Hollings bill is suspended.

8) November 1986: Huge numbers of incumbent senators and representatives of both parties are defeated at the polls, saddled with explaining their position on Gramm-Rudman-Hollings. Our Ghost of Budget Yet to Come concludes this gloomy scenario by revealing an internal staff memo that shows deficits will be $200 billion or more as far as the eye can see.

I conclude this little budget journey through time by saying that the concept behind the second scenario is a real possibility if both the president and Congress refuse to compromise on major deficit-reduction options. The amount of deficit reduction needed to meet the Gramm-Rudman-Hollings targets, or to make any real dent in deficit regardless of any law, is very large.

If the nation's leadership fails to agree by the late spring, especially in a year charged with important elections, the mechanism of Gramm-Rudman-Hollings will take effect. To allow that to happen would be a national, and even international tragedy.